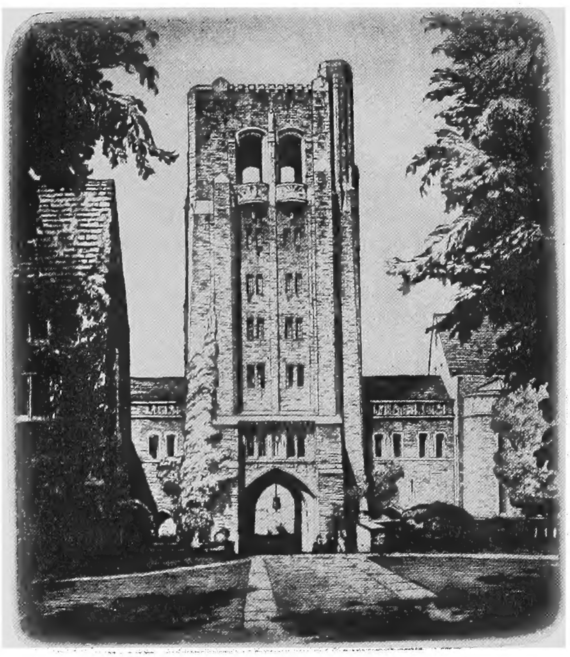

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COMMENTARIES

ON THE LAW OF

PRIVATE CORPORATIONS

BY

SEYMOUR D. THOMPSON, LL. D.

IN SIX VOLUMES.

VOLUME III.

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CONTENTS OF VOLUME III.

TITLE FIVE.

LIABILITY OF STOCKHOLDERS TO CREDITORS.

CHAPTER XLIII.

NATURE AND EXTENT OF THIS LIABILITY AT COMMON LAW.

SECTION
2925. Non-liability of members at common law.
2926. Liability of members of unincorporated, joint-stock company.
2927. Members of corporation cannot enlarge liability by a by-law, resolution, etc.
2928. But may enlarge their liability by contract.
2929. Liable to make good to creditor the amount due on their shares.
2930. This rule under various constitutions and statutes.
2931. Exception as to the necessity of a call.
2932. Liability exhausted by payment.
2933. Not liable to creditors when not liable to corporation.
2934. Exception in favor of *bona fide* purchasers in good faith.
2935. Exception where shares have been transferred in pledge by the corporation to the shareholder.
2936. Illustration: creditor of corporation holding its stock as collateral security and voting it.
2937. Liability of pledgee of a shareholder.
2938. In case of agreement by one corporation to assume debts of another.
2939. Where the corporation engages in other business than that authorized by its charter or articles.

SECTION
2940. Where the formation of the corporation is prohibited by law or public policy.
2941. Where the business for which the corporation is formed is illegal.
2942. Members of religious corporations may be personally liable.
2943. Shareholders personally liable for frauds committed in dealing with corporate assets.
2944. Not personally liable for securing to themselves a fraudulent preference.
2945. Not personally liable for *ultra vires* debts.
2946. Liability of sole stockholder.

CHAPTER XLIV.

LIABILITY IN EQUITY ON THE GROUND THAT CAPITAL IS A TRUST FUND FOR CREDITORS.

SECTION
2951. Capital stock a trust fund for creditors.
2952. Including unpaid subscriptions.
2953. Recent qualifications of this doctrine.
2954. Stockholders withdrawing the capital of the corporation bound to make it good.
2955. Rule not varied by a public registration.
2956. This trust fund, how pursued by creditors.
2957. Grounds on which courts of equity proceed.
2958. Cases in which equitable relief is invoked.
2959. Grounds of equitable relief where stock is not paid in.
2960. Equity will compel directors to make assessments.
2961. Or make the assessments by its own methods.
2962. *Bona fide* dividends of profits.
2963. Grounds of equitable relief where stock is improperly divided.
2964. Creditors entitled to share ratably.

CHAPTER XLV.

LIABILITY BEFORE ORGANIZATION COMPLETE AND CAPITAL PAID IN.

SECTION
2968. Preliminary.
2969. Until legal organization, coadventurers liable as partners.
2970. What evidence necessary to charge a person as such a partner.
2971. Theories on which members have been held liable.
2972. Will be entitled to contribution among themselves.
2973. When partners liable by estoppel after incorporation.
2974. Liability of members of joint-stock company afterwards incorporated.
2975. Distinction between prerequisite steps and directory provisions.
2976. Failing to file such articles as comply with the statute.
2977. Failing to publish statutory notices of incorporation.
2978. Recording a certificate does not cure defective articles.

SECTION
2979. Failing to keep corporate books.
2980. Failure to comply with a statute requiring the posting of by-laws.
2981. Increasing capital stock without filing new certificate, etc.
2982. Individual liability of stockholders who have not paid their subscriptions.
2983. Statutory liability until capital paid and certificate thereof filed.
2984. This liability, how measured: illustrations of it.
2985. Further of this liability.
2986. Retroactive effect of such statutes.
2987. Their extraterritorial effect.
2988. What if there is no such statute.
2989. Liability of corporators before stock is distributed.
2990. Corporation and stockholders estopped to set up irregularity of corporate organization.
2991. Conclusiveness of the certificate of incorporation.
2992. Whether creditor estopped by contracting with corporation as such.
2993. *Prima facie* evidence and burden of proof.

CHAPTER XLVI.

CONSTITUTIONAL PROVISIONS CREATING AND ABOLISHING INDIVIDUAL LIABILITY.

SECTION
2998. Constitutional guaranties securing creditors of corporations.
2999. Constitutional provisions restricting the liability to unpaid subscriptions.
3000. Constitutional provisions creating a superadded or double liability.
3001. Provision for a proportional individual liability.
3002. Constitutional guaranties securing creditors of banking companies.
3003. Whether these constitutional provisions are self-enforcing.
3004. Further of this subject.
3005. Effect of a constitutional provision creating a double liability.
3006. Missouri Constitution of 1865, and statute thereunder.
3007. Effect of Missouri constitutional amendment abolishing this double liability.
3008. Creditor may waive constitutional or statutory right to proceed against stockholders.
3009. Incorporating ostensibly for another business in order to evade the rule of individual liability.

CHAPTER XLVII.

CONSTRUCTION OF STATUTES MAKING STOCKHOLDERS PERSONALLY LIABLE FOR THE CORPORATE DEBTS.

SECTION
3013. Statutes creating individual liability construed strictly.
3014. Doctrine of strict construction denied.

SECTION
3015. Cases supporting a remedial construction.
3016. Rule of faithful or sensible construction.
3017. Such statutes, if penal, strictly construed.
3018. What statutes of individual liability penal, and what not.
3019. Statute supplanting one more onerous.
3020. Statutory remedy to be followed.
3021. Not construed as retroactive.
3022. Liability governed by statute in force when debt created.
3023. Statutory descriptions of the persons chargeable as stockholders.
3024. Words importing a superadded individual liability to the amount of stock held.
3025. Whether release of corporation under insolvent law releases shareholders.
3026. Individual liability survives in personal representative.
3027. Decisions under particular statutes.

CHAPTER XLVIII.

CONSTITUTIONAL QUESTIONS ARISING UNDER SUCH STATUTES.

SECTION
3031. General doctrine: legislative alteration of the charter void.
3032. Statutes imposing individual liability unconstitutional as to existing charters.
3033. Statutes imposing liability for future debts.
3034. Exception where the right of repeal is reserved
3035. Statutes affecting the remedy merely, not invalid.
3036. What statutes taking away remedies against stockholders have been held valid.
3037. Statutes giving a new or additional remedy to creditors.
3038. Waiver by stockholder of constitutional immunity.
3039. Invalidity of statutes substituting liability of corporation for liability of members.
3040. Statutes repealing individual liability laws, if retroactive, void.
3041. Otherwise in case of stockholders subsequently joining.
3042. Summary remedies not unconstitutional.

CHAPTER XLIX.

EXTRATERRITORIAL FORCE OF SUCH STATUTES.

SECTION
3046. Liability of resident stockholders in foreign corporation determined by law of domicile of corporation.
3047. Where the liability is in respect of unpaid shares.
3048. Suit by foreign receiver to enforce this liability.
3049. Stockholder bound by decree in insolvent proceeding without notice.
3050. Individual liability enforced *ex comitate*, unless penal.
3051. Illustrations.

SECTION
3052. What statutes of individual liability are penal and not enforceable in another State.
3053. Liability of members of migrating corporation.
3054. Where the governing statute of the foreign corporation imposes the individual liability and prescribes the remedy.
3055. Where the foreign statute requires a suit in equity.
3056. This doctrine, how applied in Massachusetts.
3057. And in West Virginia.
3058. Applied in Massachusetts so as to deny actions at law given by the law of the domicile of the corporation.
3059. Comments on the Massachusetts doctrine.

SECTION
3060. Contrary holdings on the same subject.
3061. Ancillary suit in Massachusetts for discovery.
3062. Resident members of resident corporations liable on foreign contracts.
3063. Interpretation of the foreign statute in the foreign forum followed.
3064. Remedy according to the law of the forum.
3065. Whether foreign stockholders entitled to contribution from resident stockholders.
3066. Reviving a judgment against corporation to reach property of non-resident members within the State.

CHAPTER L.

STATUTE CREATING A JOINT AND SEVERAL LIABILITY AS PARTNERS.

SECTION
3071. Classification of the statutory liability of stockholders.
3072. Nature of the liability of partners.
3073. Stockholders so liable until organization perfected and capital paid in.
3074. Other cases where they are liable as partners.
3075. "Double liability," when regarded as that of partners.
3076. Liability as partners attaches to members who are such when debt contracted.

SECTION
3077. Liability as partners that of principal debtors, not that of guarantors or sureties.
3078. Direct action against the members as partners.
3079. Limitation runs from contracting of debt.
3080. Liability several as well as joint: assets of deceased stockholders liable.
3081. Unlimited several liability without right of contribution.
3082. Liability of stockholder not merged by judgment against corporation.

CHAPTER LI.

STATUTES CREATING A SEVERAL LIABILITY.

SECTION
3086. Nature and divisions.
3087. Limited several or double liability according to stock held.

SECTION
3088. Further of this superadded "double liability."

SECTION
3089. Individual liability for amounts withdrawn or not paid in.
3090. Liability for failure to file certificates, post notices, etc.
3091. Liability for frauds under the Iowa statute.
3092. Liability in the proportion which the members' shares bear to the corporate indebtedness.
3093. Further of these statutes.
3094. Whether solvent shareholders liable to make good defaults of insolvent ones.
3095. Liable "to the amount of his stock," etc.
3096. Liability to amount of nominal capital.
3097. Liability "for all losses," etc.
3098. Not a liability to the corporation.
3099. Must be imposed by statute.
3100. Stockholders liable upon their own interpretation of their charter.
3101. Effect of statutory revision.
3102. Individual liability does not depend upon stock being paid for.
3103. Individual liability of married women as stockholders.
3104. Individual liability of stockholders in national banks.

CHAPTER LII.

FOR WHAT DEBTS THESE STATUTES MAKE STOCKHOLDERS LIABLE.

SECTION
3110. Meaning of the word "debt" in such statutes.
3111. View that judgment for damages for tort not a "debt."
3112. The opposing view.
3113. Unliquidated damages.
3114. Other demands deemed to arise *ex contractu*.
3115. *Ultra vires* debts.
3116. Debts barred by limitation.
3117. Liability not revived or extended by renewals.
3118. Debts created by indorsement.
3119. Debts contracted after suspension.
3120. Debts accruing from money loaned and misappropriated.
3121. Deposits in savings banks where no certificates are issued.
3122. Rent accruing on existing leases after insolvency.
3123. Mortgage debts under a statute.
3124. Debt paid by surety.
3125. Debts due to other stockholders.
3126. Debts due to officers of the corporation.
3127. When a debt is deemed to have been contracted.

CHAPTER LIII.

LIABILITY FOR INTEREST, FEES, AND COSTS.

SECTION
3132. Stockholder liable for interest, though not in excess of his statutory liability.
3133. Liability for interest from date of suit, although in excess of statutory liability.

SECTION
3134. View that interest is not recoverable of the stockholder.
3135. Counsel fees.
3136. From what date interest runs against stockholder.
3137. Stockholder liable for costs of proceeding against him.
3138. Liability to costs where proceeding is in equity.

CHAPTER LIV.

STATUTES MAKING STOCKHOLDERS LIABLE FOR DEBTS DUE FOR LABOR, PROVISIONS, ETC.

SECTION
3141. Such statutes fairly construed, not extended.
3142. Illustrations.
3143. Such statutes extend to assignees of the debt.
3144. Such statutes include those who work by the piece.
3145. Do not extend to the services of professional men.
3146. Engineers of works, master mechanics, conductors, etc.
3147. Manager, superintendent, foreman.
3148. Secretary of the corporation.
3149. Book-keeper.
3150. Traveling salesman, commercial traveler.
3151. Assistant editor and reporter.
3152. Contractors.
3153. Another stockholder.
3154. Another corporation.
3155. Statutory right not waived by receiving dividend, etc.
3156. Whether waived by accepting a promissory note.
3157. Whether waived by the taking of "store orders."
3158. Application of payments by the laborer.
3159. To what stockholders liability attaches: present and past stockholders.
3160. Release by the plaintiff of some of the stockholders.
3161. Defenses available to the stockholder.
3162. Remedy at law or in equity.
3163. The complaint in such actions.
3164. Parties defendant.

CHAPTER LV.

TO WHAT CLASS OF SHAREHOLDERS LIABILITY ATTACHES: PRESENT AND PAST MEMBERS.

SECTION
3169. Rule in regard to partners.
3170. General rule in regard to stockholders.
3171. Past members not liable unless by statute.
3172. Statutory liability of past members in America.
3173. Exceptional rule of liability as partners attaching to those who were stockholders when debt contracted.
3174. Results of these divergent views.
3175. Stockholders becoming such subsequent to repeal not subject to double liability.
3176. Liability for debts contracted before membership.
3177. Exception where the liability is that of partners.
3178. Exception where the liability is in the nature of a penalty for a wrongful act.

SECTION
3179. As for contracting debts before stock paid in.
3180. Statutes under which liability attaches to those who are members at the time the liability is sought to be enforced.
3181. Statutes fixing liability upon those who were stockholders when payment refused.
3182. At the time of the commencement of the action against the corporation.
3183. At the time when suit brought to charge stockholders.
3184. At the time of suing out *scire facias* for execution against the stockholder.
3185. At the time when execution against corporation returned *nulla bona*.
3186. Assignee of shares not liable for fraudulent dividends received by his assignor.
3187. Effect of renewals.

CHAPTER LVI.

STATUS AND LIABILITY OF LEGAL AND EQUITABLE OWNERS OF SHARES.

SECTION
3192. General rule.
3193. Legal owner liable.
3194. Trustees when liable personally.
3195. Statutes making the trust estate liable and exonerating the trustee.
3196. Trustees holding shares for the company.
3197. Trustee concealing his trust.
3198. Shares transferred to a person in trust without his knowledge or consent.
3199. Effect of trustee resigning his trust.
3200. Taking shares in name of fictitious trustee.
3201. Or in the name of any fictitious person.
3202. Or in the name of persons *non sui juris*.
3203. *Cestui que trust* not liable.
3204. Except in cases of fraud.
3205. Whether the nominee also put on the list.
3206. Assignees of insolvent estates.
3207. Whether assigned estate liable.
3208. Bankruptcy of shareholder.
3209. If company is wound up before bankruptcy.
3210. Whether discharge releases the bankrupt shareholder.
3211. Husband when liable for wife.
3212. Purchaser at execution sale of shares previously transferred.
3213. Whether pledgor or pledgee liable as a shareholder.
3214. Effect of company pledging its unissued shares.
3215. Further decisions on this question.
3216. Pledgee taking transfer in the name of an irresponsible party.

CHAPTER LVII.

DIVESTITURE OF LIABILITY BY TRANSFERRING SHARES.

ART. I. IN GENERAL. §§ 3221–3228.
II. RIGHT OF SHAREHOLDER TO DIVEST HIS LIABILITY. §§ 3231–3250.

ART. III. FRAUDULENT TRANSFERS TO ESCAPE LIABILITY. §§ 3255–3266.
IV. TRANSFERS TO PERSONS INCAPABLE OF CONTRACTING. §§ 3270–3279.
V. EXONERATION OF THE TRANSFEROR. §§ 3283–3297.
VI. LIABILITY OF THE TRANSFEREE. §§ 3301–3313.

ARTICLE I. IN GENERAL.

SECTION
3221. *Bona fide* transfer terminates liability of transferor.
3222. Transferee succeeds to rights and liabilities of transferor.
3223. Exception in favor of *bona fide* purchasers of shares which purport to be paid up.
3224. Contrary rule under exceptional charters and statutes.
3225. Exceptional rule in Pennsylvania.
3226. Exceptional rule in Ohio.
3227. Under Virginia code both transferor and transferee liable.
3228. Exception in case of liability for laborers' wages.

ARTICLE II. RIGHT OF SHAREHOLDER TO DIVEST HIS LIABILITY.

SECTION
3231. Right to transfer shares.
3232. No implied power to restrain alienation of shares.
3233. By-laws restraining transfers of shares void.
3234. Valid only so far as necessary to protect rights of corporation.
3235. Distinction between by-law and charter provision restraining such alienation.
3236. How as to national banks.
3237. Restraining transfers.
3238. By-laws prohibiting transfers while transferor indebted to corporation.
3239. Interpretation of such regulations.
3240. Not retroactive.
3241. When purchaser of shares chargeable with notice of such a by-law.
3242. When transfers require approval of directors.
3243. Usage that stock not transferable where holder indebted to company.
3244. Effect of certificate transferable on its face.
3245. Power to impose such restraint in the certificate.
3246. Statutory lien of a corporation upon its shares.
3247. Lien created by articles of incorporation.
3248. Effect and extent of such lien.
3249. Effect of such a lien upon indorsers and sureties.
3250. Waiver of this lien by the corporation.

ARTICLE III. FRAUDULENT TRANSFERS TO ESCAPE LIABILITY.

SECTION
3255. General rule: fraudulent transfers to escape liability void.
3256. The English distinction between real and sham transfers.

SECTION
3257. Effect of procuring consent of the directors by fraud.
3258. Transfers after insolvency or winding-up proceedings.
3259. American doctrine: transfers to insolvent or incapable persons to escape liability, void although out-and-out.
3260. Stress laid by American judges on the question of intent.
3261. Fraudulent intent, how proved.
3262. *Ultra vires* transfers.

SECTION
3263. Transfers made with the consent of the directors but beyond their power.
3264. Reorganization for the purpose of defrauding creditors.
3265. Rule where real purchaser takes the transfer in the name of an irresponsible person to avoid liability.
3266. Transfers for the benefit of creditors of shareholders.

ARTICLE IV. TRANSFERS TO PERSONS INCAPABLE OF CONTRACTING.

SECTION
3270. Divisions of the subject.
3271. Transfers to infants.
3272. Effect of transfer through an infant to an adult.
3273. What if company wound up during minority.
3274. Ratification after majority.
3275. Married women.

SECTION
3276. Transfers of shares to the company itself void.
3277. Exceptions to this rule.
3278. Want of knowledge on part of transferor.
3279. Transfer to a non-existent or fictitious person.

ARTICLE V. EXONERATION OF THE TRANSFEROR.

SECTION
3283. General rule that who is a shareholder determined by the corporate books.
3284. General rule that transferor is liable while his name remains on the books.
3285. View that transferor is relieved unless guilty of negligence.
3286. Illustrations of this view.
3287. This view denied in Ohio.
3288. Rule where the transferor is a director.
3289. Corporation may waive formality in the transfer.
3290. Where the transfer is to the corporation itself.

SECTION
3291. Prohibited transfers.
3292. Where the transferor owns and transfers all the shares.
3293. Statutory provisions respecting notice of transfer.
3294. Statutory provisions avoiding transfers made within a given time prior to the failure of the corporation.
3295. Period at which transfer inoperative to divest liability.
3296. Where the liability is for rent accruing after transfer under a lease made before transfer.
3297. When transferor cannot impeach validity of transfer.

ARTICLE VI. LIABILITY OF THE TRANSFEREE.

SECTION
3301. Transferee may be liable notwithstanding informality of transfer.
3302. Transfers to the transferee without his consent.
3303. What will not be evidence of such consent.
3304. Error in distinguishing the numbers of the shares not material.
3305. Not necessary that the new certificate should have issued to the transferee.
3306. Transferee liable without reference to the motive of the transfer.
3307. Retransfer in pursuance of a previous agreement.
3308. Vendor in unregistered transfer may recover over against vendee.
3309. Liability to pay assessments as between vendor and purchaser.
3310. Transfer how proved to make transferee liable.
3311. Point of time at which liability attaches to transferee.
3312. Shares transferable free from liability when it has been exhausted.
3313. Purchasers at execution sale.

CHAPTER LVIII.

LIABILITY OF EXECUTORS, ADMINISTRATORS, HEIRS, AND LEGATEES.

SECTION
3317. Corporate shares pass not to the heir, but to the executor or administrator.
3318. The estate liable: not the executor or administrator.
3319. Doctrine in Massachusetts that estate not liable.
3320. The general American doctrine.
3321. Distinction between a statutory penalty and a liability arising out of contract.
3322. Charter extended and debts contracted after the death of stockholder.
3323. Whether executor or legatee a contributory.
3324. Right of executor to contribution against residuary legatee.
3325. Heirs assessable to the extent of assets received from ancestor.
3326. Mode of enforcing contribution from estate of deceased shareholder.
3327. By a proceeding in equity.
3328. Suing executor without proceeding in probate court.
3329. Time within which demand against estate of deceased stockholder presented.
3330. When executor personally liable.
3331. Executor personally liable for breach of trust.
3332. Liability of the estates of deceased non-resident stockholders.
3333. Creditors not to be delayed until settlement of the estates of deceased shareholders.
3334. Executors *de son tort*.
3335. English doctrine on this subject considered.

CHAPTER LIX.

CONDITIONS PRECEDENT TO THE RIGHT TO PROCEED AGAINST STOCKHOLDERS.

ART. I. DISSOLUTION OF THE CORPORATION. §§ 3340–3348.
II. NECESSITY OF THE CREDITOR EXHAUSTING HIS REMEDY AT LAW. §§ 3351–3363.
III. WHAT WILL EXCUSE THIS NECESSITY. §§ 3367–3371.
IV. OTHER CONDITIONS PRECEDENT. §§ 3374–3388.

ARTICLE I. DISSOLUTION OF THE CORPORATION.

SECTION
3340. Scope of this chapter.
3341. Dissolution of the corporation does not extinguish its debts.
3342. Consequences of this principle.
3343. Effect of dissolution upon the liability of stockholders.
3344. Statutes making the liability of stockholders depend on a dissolution of the corporation.
3345. What constitutes a dissolution of the corporation such as lets in remedies against the stockholders.
3346. Failing to elect officers, and sold out under execution.
3347. Becoming utterly bankrupt.
3348. How fact of dissolution pleaded.

ARTICLE II. NECESSITY OF CREDITOR EXHAUSTING HIS REMEDY AT LAW.

SECTION
3351. General rule that creditors must exhaust remedy against corporation before proceeding against stockholder.
3352. Under some theories, even where the liability is said to be primary.
3353. As under the New York Manufacturing Act.
3354. When judgment at law against corporation necessary to let in equitable relief against the stockholders.
3355. Facts not sufficient to dispense with a judgment at law.
3356. Sufficient to exhaust ordinary legal remedies.
3357. Measure of diligence is judgment, *fieri facias*, and *nulla bona*.
3358. Not necessary to exhaust remedy against corporation where liability of stockholder is primary.
3359. Further of this subject.
3360. Theory that the liability may be that of a partner and yet secondary.
3361. Theory that the liability is secondary and collateral.
3362. Exceptional rules under which not necessary to recover judgment against corporation.
3363. Whether the return of *nulla bona* is conclusive against the shareholder.

ARTICLE III. WHAT WILL EXCUSE THIS NECESSITY.

SECTION
3367. Dissolution of the corporation.
3368. Appointment of a receiver.
3369. *De facto* dissolution not sufficient where the claim sounds in damages.
3370. Failure to comply with statutory requirements so as to become incorporate.
3371. Either corporation must be insolvent generally, or creditor must have exhausted his remedies against it.

ARTICLE IV. OTHER CONDITIONS PRECEDENT.

SECTION
3374. Proving claim before receiver.
3375. Dispenses with necessity for judgment, even where the statute requires a judgment.
3376. Exhausting deposits made with the State.
3377. Exhausting equitable assets before statutory liability.
3378. Exhausting remedy against other judgment debtors of corporation.
3379. Not necessary to exhaust individual liability before subjecting what is due on share subscriptions.
3380. Making demand upon the corporation or its officers.
3381. What necessary to a good demand.
3382. Notifying stockholder of proceeding against corporation.
3383. Giving notice to stockholder of the default of the corporation.
3384. Commencing action against the corporation within a given time.
3385. Call by directors not necessary to right of action by creditor.
3386. Assessing the shareholders after insolvency.
3387. Validity of this assessment.
3388. Tender of a certificate not necessary.

CHAPTER LX.

EFFECT OF JUDGMENT AGAINST THE CORPORATION.

SECTION
3392. Judgment against corporation conclusive.
3393. Theory and extent of this doctrine.
3394. Application of the rule.
3395. Theory of this rule: privity of stockholder with the corporation.
3396. Conflicting decisions in New York.
3397. New York rule different in respect of liability for unpaid shares: judgment *prima facie* evidence against stockholder.
3398. Where the action is against trustees to enforce a personal liability for failing to file reports.
3399. Doctrine that a judgment against the corporation is *prima facie* evidence of the debt in a proceeding against the stockholder.
3400. Subject to be impeached for collusion or fraud.
3401. Conclusiveness of judgments by default.

SECTION
3402. Going behind the judgment where the stockholder is liable only for a particular class of debts.
3403. Judgment against corporation after dissolution, not evidence to charge stockholder.
3404. Decree assessing shareholders in winding-up proceedings conclusive without personal service.
3405. Whether suit against stockholder is upon judgment or original demand.
3406. Right of stockholder to appeal or prosecute error from judgment against corporation.
3407. Recitals in judgment against corporation not evidence against stockholder.
3408. Conclusiveness of judgment in supplementary proceeding against stockholder.

CHAPTER LXI.

REMEDIES AND PROCEDURE.

ART. I. THEORIES AND STATUTES UNDER WHICH REMEDY IS AT LAW. §§ 3413–3424.
II. THEORIES AND STATUTES UNDER WHICH REMEDY IS IN EQUITY. §§ 3428–3442.
III. WHERE THE CREDITOR IS ALSO A STOCKHOLDER. §§ 3446–3450.
IV. RULES IN PARTICULAR JURISDICTIONS. §§ 3453–3476.

ARTICLE I. THEORIES AND STATUTES UNDER WHICH REMEDY IS AT LAW.

SECTION
3413. Remedy at law where stockholder in default in payment of calls.
3414. Doctrine that where statute creates a right and prescribes no remedy, remedy at law.
3415. Remedy at law where liability is that of a partner.
3416. When legal and equitable remedies concurrent.
3417. Right of individual creditors to proceed at law ousted by a general winding-up proceeding.
3418. When the remedy exists at law.
3419. Receiver, assignee, or trustee may sue at law for assessments.
3420. Creditor's bill, when not practicable.
3421. Bill in equity by receiver of a corporation against its stockholders.
3422. In case of a foreign corporation.
3423. Continued: distinction between a contractual and a statutory liability.
3424. Continued, with illustrative holdings.

Article II. Theories and Statutes Under Which the Remedy Is in Equity.

Section

3428. Grounds of stockholders' liability in equity: holding assets of the corporation.
3429. As where they have not paid up their share subscriptions.
3430. Or where the assets have been improperly divided among the stockholders.
3431. In case of a statutory individual liability.
3432. Reasons of the doctrine that the equity forum is exclusive.
3433. Where the proceeding is to enforce contracts made in behalf of the corporation prior to its organization.
3434. Remedy in equity where statute liability is to creditors as a class.
3435. Or where the statute creates a common fund for creditors.
3436. Inapplicability of the doctrine that equity will not relieve one who has a remedy at law.
3437. Grounds on which concurrent jurisdiction in equity supported.
3438. On the ground of discovery.
3439. Bill by a foreign corporation to discover domestic stockholders.
3440. Where the liability is in proportion to the stock held.
3441. In case of deceased shareholders.
3442. When court will not restrain proceedings at law.

Art. III. Where the Creditor Is Also a Stockholder.

Section

3446. Remedy exclusively in equity.
3447. Rule not applicable where creditor stockholder has satisfied his own liability.
3448. Whether assignee of a stockholder may sue at law.
3449. Cases disaffirming or qualifying the rules.
3450. Circumstances estopping the stockholder from maintaining any kind of action.

Art. IV. Rules in Particular Jurisdictions.

Section

3453. Rule in the United States courts.
3454. Alabama.
3455. California.
3456. Colorado.
3457. Connecticut.
3458. Florida.
3459. Georgia.
3460. Illinois.
3461. Indiana.
3462. Iowa.
3463. Kansas.
3464. Maine.
3465. Maryland.
3466. Massachusetts.
3467. Minnesota.
3468. Missouri.
3469. New York.
3470. Ohio.
3471. Oregon.
3472. Pennsylvania.
3473. Rhode Island.
3474. South Carolina.
3475. Washington.
3476. Wisconsin.

CHAPTER LXII.

PARTIES TO PROCEEDINGS BY CREDITORS AGAINST STOCKHOLDERS.

Art. I. Creditors as Parties Plaintiff. §§ 3481–3489.
II. Shareholders as Parties Defendant. §§ 3492–3505.
III. The Corporation as a Party Defendant. §§ 3509–3515.

Article I. Creditors as Parties Plaintiff.

Section
3481. Two theories as to the scope of equitable relief.
3482. Reconciling these theories.
3483. Theory that suit in equity must be on behalf of all creditors.
3484. Other creditors let in because entitled to share ratably.
3485. Amending bill or petition so as to make it the suit of all creditors.
3486. When not necessary to join all creditors.
3487. Equity rule embodied in the codes of procedure.
3488. Dormant partners: *cestui que trust*.
3489. Creditors proceed separately at law.

Article II. Shareholders as Parties Defendant.

Section
3492. Two courses open to the creditor.
3493. Theory that all shareholders within jurisdiction are necessary parties to creditor's bill.
3494. Contrary theory that it is not necessary to join all the stockholders.
3495. Stockholders out of the jurisdiction need not be joined.
3496. All stockholders proper parties.
3497. Not necessary to make shareholders defendants in order to secure appointment of receiver.
3498. Joint action by a single creditor against all the stockholders.
3499. Recent theory that stockholders are not necessary parties to a winding-up bill.
3500. Stockholders must be sued separately at law.
3501. Except where they are liable as simple partners.
3502. Separate actions to enforce limited liability: joint actions to enforce unlimited liability.
3502 a. Rules in particular jurisdictions.
3503. Summoning the stockholder with the corporation.
3504. Whether stockholder so summoned can contest the merits.
3505. Where stock is held by partnership firm.

Article III. The Corporation as a Party Defendant.

Section
3509. When the corporation must be joined.
3510. Corporation a necessary party to suit to sequester unpaid subscriptions.
3511. Judgment against corporation and subsequent action against stockholder.
3512. Whether the corporation a necessary party to enforce a statutory individual liability.
3513. Corporation when a proper party in an action to enforce an individual liability.
3514. Right of corporation to appeal from order assessing stockholders.
3515. Conclusion: in equity all creditors, all shareholders, all adverse claimants, and the corporation should be joined.

CHAPTER LXIII.

PROCEEDINGS IN EQUITY.

Art. I. Nature and Incidents of Creditors' Bills in Such Cases. §§ 3518–3523.
II. Questions of Pleading and Procedure. §§ 3526–3533.
III. The Relief Granted. §§ 3536–3545.

Article I. Nature and Incidents of Creditors' Bills in Such Cases.

Section
3518. Nature of a creditor's bill in such cases.
3519. This distinction under the statutes of New York and Wisconsin.
3520. Auxiliary relief by injunction.
3521. Necessity of a judgment at law.
3522. Creditors need not first endeavor to induce corporation to sue.

Article II. Questions of Pleading and Procedure.

Section
3526. Questions of pleading in such creditors' bills.
3527. Multifariousness.
3528. Issues not determined by original complaint.
3529. Not necessary to give stockholders fresh notice of claims of creditors subsequently coming in, in order to support judgments by default.
3530. Averments to excuse the bringing in of insolvents and non-residents.
3531. Objection for want of parties when waived.
3532. Joining an action to enforce unpaid subscriptions with an action to enforce individual liability.
3533. Stockholders not permitted to sever in their defenses.

Article III. The Relief Granted.

Section
3536. Form of relief.
3537. Ordering an assessment upon the stock.
3538. Order of assessment not granted until general assets exhausted.
3539. Assessments and contributions to be ratable.
3540. Assessing solvent stockholders to make up deficiencies.
3541. To what extent resident stockholders assessed where some are non-residents.
3542. Making additional assessments where prior ones prove insufficient.
3543. Form and substance of the decree.
3544. Entering a decree as to the rights of those before the court.
3545. Distribution where the plaintiff is himself a stockholder.

CHAPTER LXIV.

RIGHT OF ACTION IN RECEIVER, ASSIGNEE, ETC.

Section
3549. Scope of this chapter.
3550. The general rule stated.
3551. General rule that right of action for unpaid subscriptions passes to receiver, assignee, trustee, etc.
3552. Right of action in assignee in bankruptcy.
3553. Right of action in assignee for creditors under State assignment law.
3554. Right of action in transferee of stock subscriptions.
3555. Right of action in purchaser of assets at receiver's sale.
3556. Right of action in indorsee of note of corporation.
3557. When the corporation may sue notwithstanding the appointment of a receiver, or an assignment in trust.
3558. When creditors may ignore the receiver and sue personally.
3559. Whether receivership of foreign corporation ousts creditors' right of action against domestic stockholders.
3560. General rule that right of action to enforce individual liability does not pass to receiver, assignee, trustee, etc.
3561. Exceptions to this rule.
3562. Whether receiver, etc., succeeds to a higher right of action than that of the corporation.
3563. Doctrine that he does not.
3564. Further of this subject.
3565. Continued.
3566. Statute of New York under which such right of action does not pass to the receiver.
3567. Action by receiver against individual stockholders.
3568. The doctrine illustrated by the Glenn cases.
3569. When receiver or assignee may sue in equity.
3570. Common-law action brought in name of corporation to use of receiver, assignee, etc.
3571. Judgment of Federal court within the State will furnish foundation for creditors' bill.

CHAPTER LXV.

PROCEEDINGS BY GARNISHMENT.

SECTION
3576. When debt due shareholder for his shares is attachable.
3577. When subject to garnishment under execution against corporation.
3578. An assessment must have been made and not paid.
3579. A subscription must have been payable without an assessment.
3580. And (subject to exceptions) the corporation must continue solvent.

SECTION
3581. Whether a superadded statutory individual liability can be reached by garnishment.
3582. Defenses available to the garnishee.
3583. Alabama.
3584. Illinois.
3585. Louisiana.
3586. Mississippi.
3587. Missouri.

CHAPTER LXVI.

EXECUTIONS AGAINST STOCKHOLDERS.

ART. I. GENERALLY. §§ 3591–3599.
II. UNDER THE MISSOURI STATUTE. §§ 3602–3621.

ARTICLE I. GENERALLY.

SECTION
3591. Execution against the shareholders a creature of statute.
3592. The writ of *scire facias.*
3593. Registry of judgment against corporation not a lien against shareholder's property.
3594. English statutes providing for registry of shareholders and giving creditors a right to inspect the register.
3595. Enjoining the creditor from executing his judgment against shareholders.

SECTION
3596. Summoning the stockholder in an action against the corporation.
3597. Execution against corporation with clause for levy upon property of members.
3598. Motion under Kansas statute.
3599. Execution against stockholder under Massachusetts statutes.

ARTICLE II. UNDER THE MISSOURI STATUTE.

SECTION
3602. Remedy by motion under Missouri statute.
3603. The statute a substitute for a bill in equity.

SECTION
3604. Is a proceeding in the same court which rendered the judgment.

Section
3605. Motion against each stockholder is a separate proceeding.
3606. Service outside the State does not confer jurisdiction.
3607. Judgment rendered after legal dissolution of corporation will not support proceeding.
3608. Liability fixed by return of execution *nulla bona*.
3609. Evidence of corporate insolvency: return of *nulla bona*.
3610. What if execution against corporation returned before return day.
3611. Return not presumed to be premature because not dated.
3612. Informalities waived by appearance.
3613. No jury trial.
3614. Appellate court will review the evidence.

Section
3615. Whether the motion should be preserved in the bill of exceptions.
3616. Not necessary to take and save exception to the order disposing of the motion.
3617. Proceeding does not abate on death of stockholder pending appeal.
3618. Motion not maintainable against administrator of deceased stockholder.
3619. Burden of proof.
3620. Motion not maintainable after general assignment for creditors.
3621. Second motion, if dismissed, not fatal to recovery on first motion.

CHAPTER LXVII.

QUESTIONS OF PROCEDURE.

ART. I. QUESTIONS OF PLEADING. §§ 3625–3645.
II. QUESTIONS OF EVIDENCE. §§ 3650–3665.
III. OTHER QUESTIONS OF PROCEDURE. §§ 3669–3676.

ARTICLE I. QUESTIONS OF PLEADING.

Section
3625. Joinder of different causes of action against stockholder.
3626. Necessity of pleading the statute creating the liability.
3627. Averment of the facts on which the statute predicates the liability.
3628. Manner of alleging indebtedness of corporation.
3629. Averments as to time when debt contracted.
3630. Plaintiff's allegations where the liability is for unpaid shares.
3631. Allegations of exhausting legal remedies against corporation.

Section
3632. Averment of insolvency or dissolution.
3633. Averment of the amount of stock held by defendant.
3634. Averment of the power of the corporation to issue the shares.
3635. Allegation that the shares are assessable.
3636. Not necessary to aver want of knowledge that the shares were not paid for.
3637. Averment of a call.
3638. The same, in statutory action by sheriff in lieu of garnishment.

SECTION
3639. Not necessary to aver issue and delivery of certificate.
3640. Not necessary to aver that all the stock was not subscribed.
3641. Not necessary to aver how the defendant became a stockholder.
3642. Sufficiency of averment in actions by receiver against individual shareholders.
3643. When not necessary to declare against the stockholders as partners.
3644. The prayer for relief.
3645. Common-law action brought by stockholder in name of corporation.

ARTICLE II. QUESTIONS OF EVIDENCE.

SECTION
3650. Questions of fact in actions to charge stockholders.
3651. Necessity of proving existence of the corporation.
3652. Manner of proving the existence of the corporation.
3653. Evidentiary effect of certificate of organization.
3654. Certificate of corporate officer that capital has been paid in.
3655. Effect of failing to prove that the defendant is a stockholder.
3656. Manner of proving this fact.
3657. Corporate records as evidence against the stockholder.
3658. Further of this subject.
3659. Continued.
3660. What judicial records admissible, and what not.
3661. Evidence to establish the debt.
3662. Declarations made by the defendant to other creditors.
3663. Evidence to charge the members on ground of fraud.
3664. Evidence of the insolvency of other stockholders.
3665. Evidence of fraudulent over-valuation of property transferred in payment of shares.

ARTICLE III. OTHER QUESTIONS OF PROCEDURE.

SECTION
3669. Questions of *res judicata*.
3670. Right of trial by jury.
3671. Reference to a master or referee.
3672. Appeal and writs of error.
3673. Conclusiveness of the finding on questions of fact where the trial is at law.
3674. Stockholders not entitled to separate trials.
3675. Filing notice of *lis pendens* to purchaser.
3676. Other points of practice.

CHAPTER LXVIII.

DEFENSES TO ACTIONS AGAINST STOCKHOLDERS BY OR ON BEHALF OF CREDITORS.

ART. I. IN GENERAL. §§ 3679–3681.
II. DEFENSES AFFECTING THE CORPORATION AND ITS MANAGEMENT. §§ 3683–3688.

ART. III. DEFENSES AFFECTING THE STATUS AND LIABILITY OF THE DEFENDANT AS A SHAREHOLDER. §§ 3691–3707.
IV. DEFENSES AFFECTING THE DISCHARGE AND RELEASE OF THE DEFENDANT AS A SHAREHOLDER. §§ 3711–3725.
V. DEFENSES AFFECTING THE PLAINTIFF'S DEMAND. §§ 3729–3737.
VI. DEFENSES RELATING TO THE CONDUCT OF THE CREDITOR AFFECTING HIS DEMAND. §§ 3740–3748.
VII. DEFENSES RELATING TO THE CONDUCT OF THE PROCEEDING TO CHARGE THE STOCKHOLDER. §§ 3751–3755.
VIII. OTHER DEFENSES. §§ 3758–3763.

ARTICLE I. IN GENERAL.

SECTION
3679. Scope of this chapter.
3680. General theories as to defenses which can be interposed.
3681. Defenses that the stockholders are estopped from raising.

ARTICLE II. DEFENSES AFFECTING THE CORPORATION AND ITS MANAGEMENT.

SECTION
3683. That the corporation had no legal existence.
3684. That the corporation has been guilty of illegal acts.
3685. That the corporate enterprise has been abandoned.
3686. That the corporation has ceased to exist, etc.
3687. That the corporation changed its name after the defendant subscribed for the shares.
3688. That the corporate officers have been guilty of misconduct.

ARTICLE. III. DEFENSES AFFECTING THE STATUS AND LIABILITY OF THE DEFENDANT AS A SHAREHOLDER.

SECTION
3691. That the defendant never was a stockholder.
3692. When a shareholder estopped from making this defense.
3693. That the defendant did not become a stockholder in the regular mode.
3694. That some of the new stock was not taken.
3695. That some of the stock is owned by the corporation itself.
3696. That the full amount was not subscribed.

SECTION
3697. That the subscription was made prior to the formation of the corporation.
3698. That the defendant became a stockholder after the debt was contracted.
3699. That the defendant was a holder of preferred stock merely.
3700. That the shares were held by the defendant for another.
3701. That the shares were held for the corporation itself.

SECTION
3702. That the defendant held the shares as pledgee of the corporation.
3703. That the stockholder is a sovereign State.
3704. That the officers are liable before stockholders.
3705. That one of the members of the company has died, it being unincorporated.
3706. That the stockholders have a right of renewal.
3707. That the stockholder was induced to subscribe by fraud.

ARTICLE IV. DEFENSES AFFECTING THE DISCHARGE AND RELEASE OF THE SHAREHOLDER.

SECTION
3711. That the defendant has paid his subscription in full.
3712. That such payment was made in property, services, etc.
3713. That the defendant has discharged his liability by payment to other creditors.
3714. Further of this subject.
3715. That the defendant purchased the shares in good faith, believing them to have been fully paid up.
3716. Burden of showing non-payment.
3717. Manner of proving payment.
3718. That the defendant was released from his obligation by the corporation.

SECTION
3719. That the personal liability of the stockholders has been waived or released by contract.
3720. Interpretation of such contracts of waiver.
3721. That the defendant's liability was divested by transfer.
3722. That the defendant has been discharged in bankruptcy.
3723. Whether assignee in bankruptcy can be made a contributory.
3724. Assignee not bound to indemnify bankrupt against calls.
3725. That the defendants are entitled to be discharged as sureties.

ARTICLE V. DEFENSES AFFECTING THE PLAINTIFF'S DEMAND.

SECTION
3729. That the judgment against the corporation was erroneous or informal.
3730. That the judgment against the corporation was collusive.

SECTION
3731. That the demand is invalid, the corporation having admitted it.
3732. That the debt was revived after being extinguished.

SECTION
3733. That the debt was usurious.
3734. That the debt was *ultra vires*.
3735. That the debt has been satisfied in whole or in part.
3736. That the corporation has been discharged in bankruptcy.
3737. That the plaintiff purchased his demand against the corporation at a discount.

ARTICLE VI. DEFENSES RELATING TO THE CONDUCT OF THE CREDITOR, AFFECTING HIS DEMAND.

SECTION
3740. That the plaintiff has taken out execution against the corporation.
3741. That the corporation has gone into bankruptcy, and that the creditor has received dividends.
3742. That the complainants have received a dividend from an assignee of the corporation.
3743. That the plaintiff failed to present his claim to the receiver.
3744. That the plaintiff has been secured by a pledge of the corporate property.
3745. That the plaintiff granted extensions of time to the corporation.
3746. That the plaintiff has compromised with other stockholders.
3747. That the plaintiff has released other stockholders.
3748. That the plaintiff took an assignment of debts due the corporation, and then compromised with the debtors.

ARTICLE VII. DEFENSES RELATING TO THE CONDUCT OF THE PROCEEDING TO CHARGE THE STOCKHOLDER.

SECTION
3751. That the receiver was improperly appointed.
3752. That the assessment was irregular.
3753. That the defendant did not have notice of the assessment.
3754. That the decree of assessment was collusive.
3755. That the decree of assessment authorized a compromise.

ARTICLE VIII. OTHER DEFENSES.

SECTION
3758. That other creditors are entitled to priority of demand.
3759. That a prior judgment has been rendered against the defendant.
3760. That a prior suit is pending.
3761. That the assets of the corporation are unappropriated.
3762. That there is a solvent judgment debtor other than the corporation.
3763. That the receiver or assignee has been guilty of misconduct in dealing with the assets.

CHAPTER LXIX.

LIMITATION OF ACTIONS BY OR ON BEHALF OF CREDITORS.

ART. I. GENERAL PRINCIPLES. §§ 3766–3775.
II. WHEN SUCH STATUTES BEGIN TO RUN. §§ 3779–3782.

ARTICLE I. GENERAL PRINCIPLES.

SECTION
3766. Preliminary statement.
3767. Statutes of limitation applicable to penalties.
3768. Statutes exonerating stockholders unless action brought against corporation within a given time.
3769. In the case of notes which have been renewed.
3770. Where the creditor sues to sequester unpaid balances.
3771. Filing of general creditors' bill arrests the running of the statute as to creditors subsequently joining.
3772. Prescription under the code of Louisiana.
3773. Delay and laches.
3774. Presumption of payment from lapse of time.
3775. Why a judicial call does not rebut this presumption of payment.

ARTICLE II. WHEN SUCH STATUTES BEGIN TO RUN.

SECTION
3779. Generally from the date of the call under which the action is brought.
3780. Where the statute gives a joint action against the corporation and the stockholders.
3781. From the date of the appointment of a receiver.
3782. In case of a motion for execution under the Missouri statute.

CHAPTER LXX.

SET-OFF.

ART. I. IN GENERAL. §§ 3785–3804.
II. UNDER PARTICULAR STATUTES. §§ 3809–3813.

ARTICLE I. IN GENERAL.

SECTION
3785. Right exists where the corporation is a going concern.
3786. Ceases when the corporation becomes insolvent.
3787. Reasons which deny the right after insolvency.
3788. Right exists where there are no other creditors.
3789. Right exists where the debt of the corporation is a trust fund.

SECTION
3790. Where the statute gives a direct proceeding at law.
3791. Special contract for a right of set-off.
3792. Distinction between cases where the set-off is executed and where it is unexecuted.
3793. If the shareholder is a bankrupt.
3794. Whether payment of corporate debts pleadable by way of set-off.
3795. Whether stockholder may compound with creditors.
3796. Release by a creditor of a particular shareholder.
3797. Shareholder cannot buy claims at a discount and plead them as offsets.
3798. But may prove as a creditor claims which he has purchased at a discount.
3799. And for stronger reasons a stranger may do so.
3800. Company may set off calls against its own debt.
3801. Setting off unpaid dividends against debts of the corporation.
3802. Where the indebtedness to the stockholder has collateral security.
3803. Shareholder can only assign debt of company subject to right of set-off.
3804. Policy-holders cannot set off loss against liability on premium note.

ARTICLE II. UNDER PARTICULAR STATUTES.

SECTION
3809. Under section 10 of New York Manufacturing Law.
3810. Under the New York Business Companies Act of 1875.
3811. In a proceeding by motion under Missouri statute for execution against the stockholder.
3812. Under Maine statute.
3813. Under Georgia statute.

CHAPTER LXXI.

CONTRIBUTION AMONG STOCKHOLDERS.

SECTION
3816. Shareholder paying more than his proportion entitled to contribution.
3817. But only after exhausting remedy against corporation.
3818. Right given by statute.
3819. Theories of contribution in winding-up proceedings.
3820. Extent to which shareholders liable to contribute as among themselves.
3821. Whether interest recoverable in a suit for contribution.
3822. Form of the decree enforcing contribution.
3823. Cases denying the right of contribution without reason.
3824. Cases denying contribution with good reason.
3825. Voluntary payment does not create right of contribution.
3826. No contribution where the aggregate debts exceed the liabilities of all the stockholders.
3827. Liability for contribution under special contracts.
3828. Actions for contribution against non-resident stockholders.
3829. Contributions in actions at law.

CHAPTER LXXII.

PRIORITIES AMONG CREDITORS.

SECTION
3833. Legal priorities preserved in equity.
3834. Judgments satisfied in the order of their date.
3835. Whether a judgment creditor obtains a priority by the filing of his bill.
3836. Distinction as to priorities between creditors' bill and winding-up proceedings.
3837. State entitled to be preferred as a creditor.
3838. Priority of creditor first suing stockholder.

SECTION
3839. Doctrine on this subject in Maine.
3840. Contrary view that the creditor first suing gets no priority.
3841. Whether a stockholder can give a preference to particular creditors.
3842. What if creditor holds property of the corporation delivered in pledge.
3843. Priority of a mortgage of uncalled amounts due upon stock subscriptions.

TITLE SIX.

DIRECTORS.

CHAPTER LXXIII.

RIGHT TO THE OFFICE.

SECTION
3850. Necessity of electing a board.
3851. Effect of failure to elect: tenure of the office holding until successor chosen.
3852. Mode of compelling election.
3853. Power to fill vacancies.
3854. Power to remove members of the board.
3855. Grounds of removal by judicial action.
3856. *Mandamus* to restore.
3857. Who eligible.
3858. When need not be a stockholder.
3859. Statutes and by-laws requiring such a qualification.
3860. Whether must be a registered stockholder.

SECTION
3861. Convening the meeting to elect.
3862. Notice of the meeting.
3863. Directors elected after date appointed for election.
3864. Elections at adjourned meetings.
3865. Elections at meetings held outside the State.
3866. Manner of voting.
3867. Frauds and irregularities in the conduct of the election.
3868. Majority of all the shares necessary to elect.
3869. Effect of voting for ineligible candidates.
3870. Right to vote.
3871. Voting in respect of shares held by executors or trustees.

SECTION
3872. Right to vote as between pledgor and pledgee.
3873. Voting in respect of shares held by other corporations.
3874. Statutory limit as to the number of votes which can be cast by a single shareholder.
3875. Disqualifications of the shareholder claiming the right to vote.
3876. Right to vote by proxy.
3877. No superintendence of such elections in equity.
3878. But equity possesses an imperfect jurisdiction.
3879. Jurisdiction by *quo warranto*.
3880. Reviewing such elections under New York statute.
3881. Under California statute.
3882. Persons suing for the office must prove qualification.
3883. Directors suing at law must show title.
3884. Evidence to prove such title: adoption: recognition.
3885. Evidence to prove acceptance of the office.
3886. Resignation or abandonment of the office.
3887. Abandonment or forfeiture by reason of becoming disqualified.

CHAPTER LXXIV.

DIRECTORS AND OFFICERS DE FACTO.

SECTION
3893. General statement of doctrine.
3894. Who are directors *de facto*.
3895. Persons ineligible to the office.
3896. Who are not directors *de facto*.
3897. Title to office cannot be impeached collaterally.
3898. What if two boards are in existence and acting.
3899. Acts of directors *de facto* bind the stockholders.
3900. Cases showing the extent of protection under the rule.
3901. Personal liability of *de facto* directors.

CHAPTER LXXV.

QUORUM OF DIRECTORS AND NUMBER THAT CAN ACT.

SECTION
3904. Preliminary.
3905. Directors must act together as a board.
3906. Individual directors have no authority as such.
3907. But may be agents by special appointment.
3908. Separate assent of a majority not binding.
3909. Cannot vote at board meetings by proxy.
3910. Where the act is private all must join: where it is public a majority may act.
3911. Rule as to public acts applicable to private corporations: a majority of the directors rule.
3912. Distinction between a select and indefinite body in respect of a quorum.
3913. Majority of all the directors necessary to a quorum.

SECTION
3914. But a majority of the assembled quorum may act.
3915. Acts at board meeting without a quorum voidable.
3916. Must be a quorum of each integral part.
3917. Rule in case of unfilled vacancies.
3918. In the case of a special committee a majority of all must concur.
3919. Effect of the disqualification of a member of the quorum.
3920. What is a quorum where the directory has been enlarged by a consolidation with another corporation.
3921. By-law fixing quorum at less than a majority.
3922. Whether *ex officio* trustee not a part of the quorum.
3923. Number that may act in ministerial matters.
3924. Acts of directory composed of excessive number.
3925. Directors no power to exclude some of their board.

SECTION
3926. Presumption in favor of regular action.
3927. Extent of this presumption.
3928. Ratification of acts done by less than the requisite number.
3929. Power of a quorum to contract with their own members.
3930. Place of the president in the quorum.
3931. When take the sense of the stockholders.
3932. Majority can act only at a regular meeting.
3933. Meet outside the State.
3934. When record need not affirmatively show notice.
3935. Manner of assembling the meeting.
3936. When notice of the meeting must be given.
3937. Notice of adjourned meetings must be given.
3938. These principles varied by corporate usage.

CHAPTER LXXVI.

DELEGATION OF THEIR POWER BY DIRECTORS.

SECTION
3944. How far directors may delegate their authority.
3945. Further of this subject.
3946. Directors may not delegate the power of making assessments.
3947. May delegate ministerial duties.
3948. Whether bank directors may delegate power to discount.
3949. May appoint and remove subordinate agents.
3950. Single director no power unless appointed agent.
3951. No power in directors to confer permanent and supreme control upon a single officer.

SECTION
3952. May contract through a committee of their own members.
3953. Power of such committee to make contracts.
3954. To mortgage the property of the corporation.
3955. Authority to convey includes power to execute suitable instruments.
3956. Powers of committees in respect of litigation.
3957. Such committee no power to purchase real estate.
3958. Power of committee appointed to examine and report.

SECTION
3959. Power of building committees of church societies.
3960. Quorum of such committee necessary to act.
3961. *Ultra vires* acts of committees made good by ratification.
3962. Corporation bound by acts of such committee within their apparent authority.
3963. Personal liability of the members of such committees.

CHAPTER LXXVII.

POWERS OF DIRECTORS.

SECTION
3967. Nature of the office in general.
3968. Divergent views as to the nature and limits of the powers of directors.
3969. English view that they are special agents only.
3970. View that directors may do whatever the corporation may do.
3971. But cannot do more.
3972. Effect of by-laws limiting their powers.
3973. Their powers not extended by by-laws.
3974. Authority within what limits supreme.
3975. The stockholders cannot act for the company.
3976. Exceptions and qualifications of this rule.
3977. Further of this rule.
3978. Directors have no common-law powers.
3979. No power to make constituent changes.
3980. Cannot apply for or accept amendment of charter.
3981. Nor accomplish this result by indirect means.
3982. Cannot make, alter, or annul by-laws.
3983. May not sell out corporate assets and business.
3984. But may alien corporate real estate in course of business.
3985. May mortgage corporate property.
3986. May assign for benefit of creditors.
3987. When assign to other trustees.
3988. May borrow money.
3989. May make and transfer negotiable paper.
3990. May assume or guarantee debts of other persons or corporations, when.
3991. May fix the salaries of corporate officer.
3992. May not fix price of shares of stock.
3993. Powers in levying assessments.
3994. When release corporate interest.
3995. Cannot give away its assets.
3996. But may make *bona fide* compromises.
3997. And conduct corporate, but not private, litigation at corporate expense.
3998. Powers of directors of banking companies.
3999. Effect of *ultra vires* acts of directors.
4000. Loss of power by lapse of time.
4001. Instances of their ordinary contracting powers.
4002. Powers under particular instruments.
4003. Their contracts not voidable because of errors of judgment.

CHAPTER LXXVIII.

OBLIGATIONS OF DIRECTORS AS FIDUCIARIES.

ART. I. IN GENERAL. §§ 4009–4053.
II. CONTRACTS BETWEEN THE DIRECTORS AND THE CORPORATION. §§ 4059–4075.
III. CONTRACTS BETWEEN TWO CORPORATIONS HAVING THE SAME DIRECTORS. §§ 4079–4087.

ARTICLE I. IN GENERAL.

SECTION
4009. Directors are trustees for the stockholders.
4010. Bound to exercise their powers for the benefit of the company.
4011. Cannot create any relation which will make their personal interests antagonistic to those of the corporation.
4012. Illustrations.
4013. Engaging in a rival business.
4014. No power to give away the assets of the company.
4015. Paying claims barred by limitation.
4016. Bound to act with the utmost good faith.
4017. Engagements contrary to their duty voidable.
4018. Illustrations.
4019. Personally liable for *ultra vires* acts.
4020. To what extent trustees for the public.
4021. To what extent trustees for creditors.
4022. Not allowed to make a profit out of their trust.
4023. Personally liable for breaches of their trust.
4024. Must account to the company for secret profits.
4025. Rule not applicable to dealings open and acquiesced in.
4026. Rule subject to the maxim that he who seeks equity must do equity.
4027. Must account for bribes given to influence their official action.
4028. Not chargeable with profits made by a third party out of their trust relation.
4029. Illustrations showing liability to account for secret profits.
4030. Further illustrations.
4031. Illustrations continued.
4032. Continued.
4033. Cannot buy shares from the company and resell at a profit.
4034. But may purchase the shares of other stockholders.
4035. But not with the funds of the company.
4036. Purchasing property from themselves for the company.
4037. Buying property for themselves and reselling to the corporation at a profit.
4038. Liable for colluding with promoters.
4039. The same subject continued.
4040. Cannot buy up claims against the company at a discount and prove them for the full amount.
4041. View that they may recover the amount expended in such purchases.

SECTION
4042. Cannot vote upon question affecting his private interest.
4043. Cannot deal for themselves with the corporate property.
4044. Illustrations.
4045. Cannot conduct their private litigation at corporate expense.
4046. Ratification of such contracts by the shareholders.
4047. What will amount to a ratification.
4048. What will not amount to a ratification.
4049. View that corporation cannot condone fraud of officer except by unanimous consent.
4050. Rights of third persons in cases of such breaches of trust.
4051. Measure of liability for such breaches of trust.
4052. All directors liable who fraudulently conspire.
4053. Liability of promoters to account for secret profits.

ARTICLE II. CONTRACTS BETWEEN THE DIRECTORS AND THE CORPORATION.

SECTION
4059. Directors may contract with the corporation in good faith.
4060. View that a director cannot contract with the company.
4061. Second view that such contracts are not void, but voidable.
4062. Third view that their validity depends upon their nature and terms.
4063. Such contracts closely scrutinized.
4064. Valid when made with unanimous consent.
4065. Voidable when a majority of the directors constitute the other contracting party.
4066. Director cannot be a secret partner in contracts between the corporation and third persons.
4067. Director may recover at law on a contract with the corporation.
4068. General doctrine that directors may lend to the corporation and take security.
4069. Are entitled to indemnity against *bona fide* expenses and advances.
4070. May purchase from the corporation.
4071. Whether allowed to purchase the corporate property at judicial or other public sale.
4072. Such purchasing director holds as trustee for the company.
4073. Form of relief in such cases.
4074. Circumstances under which such purchases have been upheld.
4075. A mere stockholder may so purchase.

ARTICLE III. CONTRACTS BETWEEN TWO CORPORATIONS HAVING THE SAME DIRECTORS.

SECTION
4079. Contracts between two corporations not void, although some of the officers in one are officers in the other.
4080. Contract not voidable if there be a quorum of directors not directors in both corporations.

SECTION
4081. Opposing view that such contracts are voidable.
4082. Voidable where the same persons are directors in both corporations.
4083. Voidable where the sole contracting agent is an officer in both corporations.
4084. Corporate agent employed by the other contracting party.

SECTION
4085. Such contracts validated by acquiescence and ratification.
4086. Director or officer may be trustee in corporate mortgage.
4087. Contract with stockholder not changeable by corporation without his consent.

CHAPTER LXXIX.

GENERAL VIEW OF THE LIABILITY OF DIRECTORS.

SECTION
4090. *Status* of directors and general nature of their liability.
4091. Their twofold liability for nonfeasance and misfeasance.
4092. General view of the remedies given.
4093. Evidence of acquiescence to charge a particular director.

SECTION
4094. Cases illustrating this question.
4095. Liability joint or several.
4096. Director may be jointly liable with the corporation.
4097. Directors not necessarily liable for the frauds of subordinate agents appointed by them.
4098. What knowledge imputable to directors and officers.

CHAPTER LXXX.

LIABILITY OF DIRECTORS FOR NEGLIGENCE.

SECTION
4100. Directors may be liable for negligence.
4101. Distinction, in respect of this liability, between discretionary and ministerial acts.
4102. Not liable for discretionary acts: liable for gross negligence in respect of ministerial duties.
4103. Not liable for mistakes of judgment.
4104. Bound to exercise ordinary business diligence.
4105. Such negligence judged by what standard: by judge or jury.
4106. Responsible for losses happening through gross negligence.

SECTION
4107. Their liability for the acts of subordinates.
4108. Their liability for negligent ignorance.
4109. Liability for negligent acts which are *ultra vires*.
4110. Effect of acquiescence on the part of the shareholders.
4111. Liability of directors for each other's acts.
4112. Liability of *ex officio* members for each other's acts.
4113. Application of these principles to banking corporations.
4114. Indictment of directors for negligent failure to perform official duties.

CHAPTER LXXXI.

REMEDIES OF THE CORPORATION OR ITS REPRESENTATIVE AGAINST ITS UNFAITHFUL DIRECTORS.

SECTION
4118. General heads of liability to the company.
4119. Corporation may sue its directors either at law or in equity.
4120. Action whether legal or equitable.
4121. Right of action in receiver, and whether he can impeach corporate acts.
4122. Right of action in assignee for creditors.
4123. Pendency of actions by creditors prevents subsequent actions by assignee.
4124. Directors when jointly liable.
4125. Pleading: declaration, bill, or complaint.
4126. Actions by assignees and trustees in bankruptcy.
4127. Certain defenses considered.
4128. Defense of the statute of limitations.

CHAPTER LXXXII.

LIABILITY OF DIRECTORS TO STRANGERS AND CREDITORS OF THE CORPORATION OUTSIDE OF STATUTE.

SECTION
4132. General nature of the liability of directors to persons not members of the company.
4133. Not liable as partners or original undertakers, except, etc.
4134. Personally liable where contract does not show that it was made for the company.
4135. Personally liable for acts in excess of their authority.
4136. Unless the question of the extent of authority is a mere question of law.
4137. Not liable to creditors for nonfeasance, negligence, mismanagement, breach of duty to corporation, etc.
4138. Bank directors not so liable to depositors.
4139. A limitation of this doctrine suggested, and contrary holdings stated.
4140. But liable to strangers for malfeasance.
4141. Such as fraudulent over issues of corporate stock.
4142. Or the fraudulent issuing of second mortgage bonds as "first mortgage bonds."
4143. Not liable for overdrafts.
4144. Issuing false prospectuses, making false representations, etc., whereby the public are deceived.
4145. Illustrations of this liability.
4146. Effect of statute of frauds.
4147. Doctrine that there must have been a guilty *scienter* or a fraudulent intent to deceive.
4148. Action by sureties against trustees for fraudulent statements.
4149. Remedies in equity.
4150. In what sense directors trustees for creditors.
4151. Liability for preferring creditors.
4152. Personally liable for fraudulently diverting the company's assets from its creditors.

SECTION
4153. Illustrations of this liability.
4154. Liability to pay for "qualification shares."
4155. Creditor may also follow misappropriated assets as a trust fund.

SECTION
4156. Corporation a party to suit in equity.
4157. Liability of a director for allotting shares to his own infant children.

CHAPTER LXXXIII.

STATUTORY LIABILITY OF DIRECTORS AND OFFICERS TO CREDITORS.

ART. I. IN GENERAL. §§ 4163–4178.
II. WHAT DEBTS OF THE CORPORATION ARE WITHIN SUCH STATUTES. §§ 4182–4201.
III. LIABILITY ATTACHES TO WHAT DIRECTORS IN RESPECT OF THE DATE OF THE DEBTS BEING CONTRACTED. §§ 4206–4213.
IV. LIABILITY FOR DEBTS CONTRACTED BEFORE ORGANIZATION. §§ 4216–4219.
V. STATUTORY LIABILITY FOR FAILING TO FILE CERTAIN REPORTS. §§ 4221–4236.
VI. LIABILITY FOR MAKING FALSE REPORTS. §§ 4240–4255.
VII. LIABILITY FOR DEBTS CONTRACTED IN EXCESS OF A PRESCRIBED LIMIT. §§ 4259–4280.
VIII. LIABILITY FOR CERTAIN PROHIBITED LOANS. §§ 4285, 4286.
IX. LIABILITY FOR DECLARING UNLAWFUL DIVIDENDS. §§ 4288–4295.
X. MISCELLANEOUS LIABILITIES AND PENALTIES. §§ 4298–4305.
XI. REMEDIES AND PROCEDURE UNDER THESE STATUTES. §§ 4308–4348.
XII. DEFENSES TO SUCH ACTIONS. §§ 4354–4372.

ARTICLE I. IN GENERAL.

SECTION
4163. General nature of this liability.
4164. These statutes penal and to be strictly construed.
4165. View that such statutes are not penal.
4166. Such statutes not enforced outside the State enacting them.
4167. Cases in which this doctrine applied.

SECTION
4168. Effect of a repeal of the statute upon accrued rights.
4169. Whether right of action dies with creditor.
4170. Effect of constitutional provision that "dues from private corporations shall be secured in such manner as shall be prescribed by law."

SECTION
4171. Validity of a statute imposing a liability after the persons sought to be charged become directors.
4172. Effect of a dissolution of the corporation.
4173. Sense in which directors jointly liable.
4174. Meaning of "jointly and severally liable."
4175. What if the act was of such a nature that it could not be done by a single director.
4176. Creditor may proceed against one or more.
4177. Theory that under statutes making both the innocent and the guilty liable, all must be joined.
4178. Example of a statute imposing a several liability.

ARTICLE II. WHAT DEBTS OF THE CORPORATION ARE WITHIN SUCH STATUTES.

SECTION
4182. Liability for torts.
4183. Mere gratuities.
4184. Security debts.
4185. Debts founded in fraud.
4186. Debts due the directors themselves.
4187. *Ultra vires* debts.
4188. Certificates of deposit.
4189. Judgments and judgments for costs.
4190. Debts which have been assigned.
4191. Wages of employés.
4192. Debts payable in future.
4193. Unliquidated damages for breaches of contract.
4194. Taxes.
4195. Debts barred by limitation: obligation of lessee to pay taxes.
4196. Renewals.
4197. Debts contracted and due in other States.
4198. Debts due to participants in the wrongs denounced by the statute.
4199. Debts due a partnership dissolved by death.
4200. Simple contract debts.
4201. Obligation to pay a guaranteed dividend.

ARTICLE III. LIABILITY ATTACHES TO WHAT DIRECTORS IN RESPECT OF THE DATE OF THE DEBTS BEING CONTRACTED.

SECTION
4206. Liability attaches only to those directors in office at the time of the default.
4207. Illustrations.
4208. Where the statute enjoins the making of a particular financial statement or report.
4209. Such as the New York Manufacturing Corporations Act.
4210. Where the statute prohibits the contracting of particular debts.
4211. Whether liable for debts contracted before the doing of the prohibited act.
4212. When the debt is deemed contracted "after such violation."
4213. Conclusiveness of action of creditor in fixing date of debt.

Article IV. Liability for Debts Contracted Before Organization.

Section
4216. The mischief which these statutes were designed to remedy.
4217. Liable for making sham payments of stock subscriptions.
4218. Liable for contracting debts before legal organization.
4219. Not liable on contracts made before being empowered by the by-laws.

Article V. Statutory Liability for Failing to File Certain Reports.

Section
4221. Introductory.
4222. Time at which the debt is deemed to accrue.
4223. The same, where the contract is to deliver or receive goods.
4224. In the county or counties where the corporation may conduct its business.
4225. Meaning of "within twenty days from the first day of January."
4226. Liability contingent upon corporate indebtedness actually due.
4227. Effect of giving time to the corporation.
4228. What will excuse the filing of such a report.
4229. Need not state how much capital paid in cash and how much in property.
4230. What is a signing by a majority of the trustees.
4231. Verification.
4232. Signing.
4233. Further of the construction of the New York Manufacturing Act.
4234. Construction of other statutes.
4235. Filing a false report not equivalent to filing no report.
4236. Publication of articles of incorporation under Iowa statute.

Article VI. Liability for Making False Reports.

Section
4240. Introductory.
4241. Nature of these statutes.
4242. Such statutes penal: strictly pursued—whether enforceable in other States.
4243. Only those liable who sign the report.
4244. *Scienter:* doctrine that the report must have been willfully false.
4245. Such willfulness a question of fact for a jury.
4246. What facts sufficient to make out a case.
4247. What reports have passed judicial scrutiny.
4248. Defense that the report was voluntary, and not such as required by the statute.
4249. Each report gives a separate cause of action.
4250. Statements of such a report.
4251. Whether directors so liable for antecedent debts.
4252. Liability to the creditors collectively under Massachusetts statute.
4253. Director is an "officer."
4254. No defense that the director is also a creditor.
4255. Questions of procedure.

Article VII. Liability for Debts Contracted in Excess of a Prescribed Limit.

Section
4259. Introductory.
4260. The making of such excessive loans a misdemeanor.
4261. Differences among the statutes as to limit of indebtedness.
4262. Loans to the directors themselves.
4263. Individual liability imposed upon what directors.
4264. Extent of the liability imposed.
4265. To whom liable: to creditors: to the corporation itself.
4266. Provisions for the exoneration of dissenting directors.
4267. Whether the corporation also liable for such excessive debts.
4268. Remedies given to enforce these statutes.
4269. Liability both for excessive debts and for deficits occasioned by insolvency.
4270. No defense that the corporation did not get the benefit.

Section
4271. No recovery unless on a case strictly within the statute.
4272. No defense that a receiver has been appointed, etc.
4273. No defense that procedings have not been taken to dissolve corporation.
4274. No defense that another action is pending against defendants as stockholders.
4275. Such statutes not enforceable in other States.
4276. Renewals, substitutions, and application of part payments.
4277. This liability extends to debts due to stockholders.
4278. Right of action not altered by corporate dissolution.
4279. What contracts are "debts" within the meaning of such statutes.
4280. Statute of limitations.

Article VIII. Liability for Certain Prohibited Loans.

Section
4285. Loans to the stockholders prohibited.

Section
4286. Construction of these statutes.

Article IX. Liability for Declaring Unlawful Dividends.

Section
4288. Introductory.
4289. The general nature of these statutes.
4290. Statutes prescribing the cases in which dividends may and may not be declared.
4291. What is not a declaration of an illegal dividend under such statutes.

Section
4292. Liable to the corporation.
4293. Remedies given by these statutes and procedure thereunder.
4294. Liable to creditor who is a stockholder.
4295. Liability under these statutes for dividends declared.

Article X. Miscellaneous Liabilities and Penalties.

SECTION
4298. Acting as agent of foreign insurance company which has not complied with the domestic law.
4299. Doing business for the corporation without a license.
4300. Receiving deposits and creating debts while insolvent.
4301. Whether such a constitutional provision self-enforcing.
4302. Official mismanagement.
4303. Liability of directors under the National Banking Act.
4304. Whether the right of action given by this section is lodged alone in a receiver.
4305. Resignation of such directors.

Article XI. Remedies and Procedure Under the Statutes.

SECTION
4308. Preliminary.
4309. Whether the remedy is at law or in equity.
4310. Doctrine of Supreme Court of United States: remedy in equity.
4311. So in Massachusetts.
4312. So in Georgia.
4313. So in Alabama.
4314. So in other States under various statutes and charters.
4315. In Kentucky, remedy at law.
4316. So in Missouri where equitable relief not sought.
4317. So in Vermont.
4318. So in New York.
4319. So, it seems, in Indiana.
4320. Action by single creditor against single director.
4321. Form of the action at law.
4322. Actions by creditors.
4323. Actions by receivers.
4324. Actions by assignees.
4325. Actions by stockholders.
4326. Actions by attorney-general in New York.
4327. Judgment against corporation a condition precedent.
4328. Exception in case of inchoate corporations.
4329. Exception in some States.
4330. Theory that judgment against corporation conclusive.
4331. Theory that such judgment not evidence against the directors.
4332. Whether judgment against corporation by garnishment a sufficient foundation for such an action.
4333. Burden of proof under such statutes.
4334. Parol evidence admissible to identify the judgment.
4335. Misjoinder of such causes of action.
4336. Pleading under such statutes: complaint must allege all the statutory grounds of recovery.
4337. What exceptions of the statute must be negatived.
4338. Averment of date of debt.
4339. Averment that the debt remains unpaid.
4340. Misdescription of the statute immaterial.
4341. Not necessary to aver how the damage happened.
4342. Other points in such complaints.
4343. Plaintiff recovers upon a preponderance of evidence.
4344. Procedure in case of the death of a director.

SECTION
4345. Rule in Massachusetts in case of insolvency proceedings against director.
4346. Other decisions under statutes of Massachusetts.
4347. Costs in proceedings under these statutes.
4348. Various matters of practice in such actions.

ARTICLE XII. DEFENSES TO SUCH ACTIONS.

SECTION
4354. Defense of no corporation.
4355. When this defense available.
4356. Defense of negligence, ignorance of law, want of guilty *scienter*.
4357. Statutes creating a presumption of assent.
4358. Director exonerated by resigning or abandoning the office.
4359. Other evidence of want of assent.
4360. Assent of the plaintiff to the prohibited act.
4361. Defense of the statute of limitations: statute relating to penalties applicable.
4362. View that such liability is in the nature of a specialty, and statutes of limitation not applicable.
4363. When the statute begins to run.
4364. Limitation as to time when action brought against corporation.
4365. Defense not available to director where corporation failed to plead it.
4366. Nor unless raised in the trial court.
4367. Defense of laches.
4368. Defense of pendency of proceedings before assignee or receiver.
4369. Defense of waste of corporate assets by assignee or receiver.
4370. Defense of set-off.
4371. Defense of former adjudication.
4372. Other defenses which have been held unavailing.

CHAPTER LXXXIV.

CONTRIBUTION AND SUBROGATION.

SECTION
4376. When wrong-doing directors entitled to contribution as among themselves.
4377. Whether contribution in case of affirmative acts done contrary to statutory prohibitions.
4378. Statutes granting or withholding this right.

CHAPTER LXXXV.

COMPENSATION OF DIRECTORS AND OFFICERS.

SECTION
4380. Directors not entitled to compensation unless, etc.
4381. Cannot vote themselves salaries or compensation.
4382. Especially after the services have been rendered.
4383. Illustrations of the two preceding sections.

SECTION
4384. Directors cannot recover for "extra" services incidental to their official duties.
4385. Illustrations of the foregoing.
4386. But may recover for services clearly outside such duties.

SECTION
4387. Illustrations of the foregoing.
4388. Services prior to organization of corporation.
4389. Recovery of money misappropriated in payment of salaries.

CHAPTER XLIII.

NATURE AND EXTENT OF THIS LIABILITY AT COMMON LAW.*

SECTION
2925. Non-liability of members at common law.
2926. Liability of members of unincorporated joint-stock company.
2927. Members of corporation cannot enlarge liability by a by-law, resolution, etc.
2928. But may enlarge their liability by contract.
2929. Liable to make good to creditor the amount due on their shares.
2930. This rule under various constitutions and statutes.
2931. Exception as to the necessity of a call.
2932. Liability exhausted by payment.
2933. Not liable to creditors when not liable to corporation.
2934. Exception in favor of *bona fide* purchasers in good faith.
2935. Exception where shares have been transferred in pledge by the corporation to the shareholder.
2936. Illustration: creditor of corporation holding its stock as collateral security and voting it.

SECTION
2937. Liability of pledgee of a shareholder.
2938. In case of agreement by one corporation to assume debts of another.
2939. Where the corporation engages in other business than that authorized by its charter or articles.
2940. Where the formation of the corporation is prohibited by law or public policy.
2941. Where the business for which the corporation is formed is illegal.
2942. Members of religious corporations may be personally liable.
2943. Shareholders personally liable for frauds committed in dealing with corporate assets.
2944. Not personally liable for securing to themselves a fraudulent preference.
2945. Not personally liable for *ultra vires* debts.
2946. Liability of sole stockholder.

§ 2925. Non-liability of Members at Common Law. — The general rule of law is that the members of a corporation are

* There is a valuable note on the liability of stockholders for debts of the corporation in 99 Am. Dec. 432 *et seq.* There is another, still more elaborate and valuable, in 5 Am. St. Rep. 806 *et seq.* There is also a note in 27 Am. Law Reg. (N. S.) 168, by Adelbert Hamilton, dealing chiefly with the subjects of assessments, calls, and actions to enforce stock subscriptions.

not liable for its debts[1] or torts,[2] except to make good the amount due to the corporation for their shares,[3] unless made so by constitutional or statutory enactment, or unless they have assumed a larger liability by contract or by conduct.[4]

[1] Shaw *v.* Boylan, 16 Ind. 384; Free Schools *v.* Flint, 13 Met. (Mass.) 539; Coffin *v.* Rich, 45 Me. 507, 511; *s. c.* 71 Am. Dec. 559; Gray *v.* Coffin, 9 Cush. (Mass.) 192, 199; French *v.* Teschemaker, 24 Cal. 518, 540; *s. c.* 71 Am. Dec. 559; Norton *v.* Hodges, 100 Mass. 241; Oliver *v.* Liverpool &c. Co., 100 Mass. 531, 539, *per* Hoar, J.; *s. c. sub nom.* Liverpool Ins. Co. *v.* Massachusetts, 10 Wall. (U. S.) 566, 575, *per* Miller, J.; Myers *v.* Irwin, 2 Serg. &. R. (Pa.) 368, 371, *per* Tilghman, C. J.; Harger *v.* McCullough, 2 Denio (N. Y.), 119; Van Sandau *v.* Moore, 1 Russ. 441, 458; Thomas *v.* Dakin, 22 Wend. (N. Y.) 9, 95, *per* Cowen, J.; Smith *v.* Huckabee, 53 Ala. 191, 193, *per* Brickell, J.; Slee *v.* Bloom, 19 Johns. (N. Y.) 456, 473; *s. c.* 10 Am. Dec. 273, *per* Spencer, C. J.; Freeland *v.* McCullough, 1 Denio (N. Y.), 414, 423; *s. c.* 43 Am. Dec. 685; Green *v.* Beckman, 59 Cal. 545; *s. c.* 9 Am. Corp. Cas. 24; Salt Lake City Nat. Bank *v.* Hendrickson, 40 N. J. L. 52; Seymour *v.* Sturgess, 26 N. Y. 134; Terry *v.* Little, 101 U. S. 216. It would perhaps be difficult to find a modern case in which the question whether the stockholder of a corporation is at common law liable to pay the debts of the concern is distinctly adjudicated; just as it would be hard to find a case raising and adjudicating the point that at common law the real estate of a deceased person goes to his heir, and his personalty to his next of kin. But the rule is found to have been recognized in many cases. Middletown Bank *v.* Magill, 5 Conn. 28, 51, *per* Hosmer, C. J.; New England Com. Bank *v.* Newport Steam Factory, 6 R. I. 154, 188; 75 Am. Dec. 688, *per* Ames, C. J.; Spense *v.* Iowa Valley Con. Co., 36 Iowa, 407. Unless made so by constitution or statute, a stockholder is not liable to creditors of the corporation for more than the amount remaining unpaid on his stock, even though other delinquent stockholders are insolvent. Mallinckrodt Chemical Works *v.* Belleville Glass Co., 34 Ill. App. 404.

[2] Thus, a man was injured by being ejected from an omnibus by its driver. The omnibus was owned and run by a corporation, and the injured person brought an action against the stockholders to recover damages for the injury. He offered no evidence tending to show any participation in the act on the part of the defendants. It was held that there could be no recovery. Peck *v.* Cooper, 8 Ill. App. 403.

[3] *Ante*, § 1078; Toner *v.* Fulkerson, 125 Ind. 224; *s. c.* 25 N. E. Rep. 218.

[4] In New England, an exception to this rule exists, to the extent that the private property of members of *quasi* corporations, such as towns, counties, etc. which have no corporate funds, is liable to be taken to satisfy a judgment against the corporate body. Adams *v.* Wiscasset Bank, 1 Me. 361; *s. c.* 10 Am. Dec. 88; Merchants' Bank *v.* Cook, 4 Pick. (Mass.) 405, 414; Brewer *v.* New Gloucester, 14 Mass. 216; Marcy *v.* Clark, 17 Mass. 330, 333; Atwater *v.* Woodbridge, 6 Conn. 223; *s. c.* 16 Am. Dec. 46; Commonwealth *v.* Blue Hill Tp. Co., 5 Mass. 420.

§ 2926. Liability of Members of Unincorporated Joint-stock Company. — On the contrary, the members of an unincorporated *joint-stock company* are jointly and severally liable, as partners, to pay the debts of the concern, unless their liability is restricted by statute.[1] In this respect, the one organization is exactly the antithesis of the other. It follows that where there is no statute limiting the liability of the members of unincorporated joint-stock companies, or other unincorporated voluntary associations, they cannot, by their own constating instruments, *restrain their liability*, as between themselves and the public, to that of an incorporated company, but such an attempt is wholly nugatory, and they remain liable as partners.[2] This liability attaches not only to the original members, but to all who subsequently join, provided they do in fact join and become members, and not merely creditors; and this is so, although the object of their joining was to support the concern with their capital and credit.[3]

§ 2927. Members of Corporation cannot Enlarge Liability by a By-law, Resolution, etc. — Moreover, the members of

[1] Walburn *v.* Ingilby, 1 Mylne & K. 61, 76; Haslett *v.* Wotherspoon, 2 Rich. Eq. (S. C.) 395, 399, 403; *s. c.* 1 Strob. Eq. (S. C.) 209, 227; Broyles *v.* McCoy, 5 Sneed (Tenn.), 602; Frost *v.* Walker, 60 Me. 468; Tappan *v.* Bailey, 4 Met. (Mass.) 535; Tyrrell *v.* Washburn, 6 Allen (Mass.), 466. "It is important for the public to know that if persons connect themselves with a company of this description, they are every one of them liable to pay the demands upon it." Abbott, C. J., in Keaseley *v.* Codd, 2 Car. & P. 408; Brinham *v.* Wellersburg Coal Co., 47 Pa. St. 43, 49. An action against the individual associates of a joint-stock association, consisting of more than seven members, cannot be brought, *under the Revised Statutes of New York* (13 Rev. Stat. N. Y., 6th ed., § 139, p. 763, *et seq.*), until the remedy has been exhausted against the president and treasurer. Robbins *v.* Wells, 1 Rob. (N. Y.) 666.

[2] Walburn *v.* Ingilby, 1 Mylne & K. 63, 76, *per* Lord Brougham; Haslett *v.* Wotherspoon, 2 Rich. Eq. (S. C.) 395, 400, 403; Pettis *v.* Atkins, 60 Ill. 454; Bigelow *v.* Gregory, 73 Ill. 197; Abbott *v.* Omaha Smelting Co., 4 Neb. 416; Frost *v.* Walker, 60 Me. 468; Wells *v.* Gates, 18 Barb. (N. Y.) 554; National Union Bank *v.* Landon, 45 N. Y. 410; Tappan *v.* Bailey, 4 Met. (Mass.) 529.

[3] See for illustration Holt *v.* Blake, 47 Me. 62. The members of a *joint-stock company* created and regulated by the laws of New York, liable as simple partners in the State of Massachusetts, are subject to be sued as such there. Taft *v.* Ward, 106 Mass. 518.

a corporation cannot, except by unanimous consent, enlarge their liability by the passage of a by-law or resolution declaring a greater liability than that fixed by their charter or by the general law. The majority of a corporation cannot thus bind the minority, contrary to the charter or the law;[1] nor does it make any difference that the member sought to be charged signed such a by-law, unless it appears that his signature was attached for some other purpose than merely to constitute him a member of the corporation.[2] But a by-law which contains a pledge of individual liability for the corporate debts, if made for the purpose of enabling the corporation to obtain a loan on the faith of it, and used for that purpose, may perhaps give a right of action against the subscribers, in favor of a party who has been induced to advance money on its credit.[3] But in an action of *assumpsit* against a member of a corporation, brought by one of its creditors to recover money lent to it, *evidence* was not admissible to prove that the defendant *informed other creditors*, when they lent money to the corporation, that its members were individually liable for its debts, and showed them a by-law of the corporation imposing such liability.[4] Where, however, a corporation not professing to have any fixed capital, made by-laws by which each of the corporators was bound to contribute equally or ratably to all the expenses incurred, it was held that the members were liable to be assessed for all the debts of the corporation.[5]

§ **2928. But may Enlarge Their Liability by Contract.** — But there is no rule of law or principle of public policy which prevents the stockholders of a corporation from enlarging their liability to the corporation or to its creditors by contract.

[1] Trustees *v.* Flint, 13 Met. (Mass.) 539; Reid *v.* Eatonton Co., 40 Ga. 98, 101; *s. c.* 2 Am. Rep. 563; Flint *v.* Pierce, 99 Mass. 68; *s. c.* 96 Am. Dec. 691.

[2] Flint *v.* Pierce, 99 Mass. 68; *s. c.* 96 Am. Dec. 691.

[3] Flint *v.* Pierce, 99 Mass. 68; *s. c.* 96 Am. Dec. 691.

[4] *Ibid.*

[5] Hume *v.* Winyaw &c. Co., 1 Carolina L. J. 217. Compare Savage *v.* Putnam, 32 Barb. (N. Y.) 420.

But as the stockholder is in law a different person from the corporation, his promise to become personally liable for the debts of the latter beyond the extent to which he stands liable under the law is a promise to answer for the debt, default, or miscarriage of another person, and is hence *within the statute of frauds*, and not enforceable unless *in writing*.[1] So where, under the law of the State, a *married woman* can only pledge her personal responsibility to effect some purpose of her own, or for the benefit of her own estate,[2] she cannot bind herself by *indorsing* a promissory note to secure the debt of a corporation of which she is a shareholder, because the estate of the corporation is not her estate, and such an indorsement is therefore not for the benefit of her estate.[3] Where the stockholder of a bank is personally liable under the law to redeem the circulating notes of the bank illegally issued, he may, of course, make a valid contract with a third person, by which the latter agrees to redeem the bills for him, and the contract will be supported by a good consideration.[4] But the fact that individual members of a corporation may have *represented to the public* that they were so liable will not bind them as stockholders; nor will equity entertain a bill against them as stockholders under such by-law, or on account of such representations. If they have incurred liabilities as individuals, disconnected from their corporate capacity, they should be proceeded against as individuals.[5] So, it has been held that if the individual property of the stockholders of a bank is not made liable for its debts, either absolutely or conditionally, and by a specified process,— an indorsement on the bills of the bank of the words "individual property of stockholders liable" does not of itself give any right of action to the billholders against the stockholders, or against

[1] Flint *v.* Pierce, 99 Mass. 68; *s. c.* 96 Am. Dec. 691.

[2] As in Michigan: Powers *v.* Russell, 26 Mich. 179; Emery *v.* Lord, 26 Mich. 431; Cooley, J., in Russel *v.* People's Sav. Bank, 39 Mich. 671; *s. c.* 33 Am. Rep. 444.

[3] Russel *v.* People's Sav. Bank, 39 Mich. 671; *s. c.* 33 Am. Rep. 444; De Vries *v.* Conklin, 22 Mich. 255; West *v.* Laraway, 28 Mich. 464.

[4] Allen *v.* Pegram, 16 Iowa, 163.

[5] Reid *v.* Eatonton Man. Co., 40 Ga. 98; *s. c.* 2 Am. Dec. 563.

the president and cashier signing the bills officially. The indorsement gives to the billholders no rights against the stockholders other than such as are given them by the charter.[1]

§ 2929. Liable to Make Good to Creditor the Amount Due on Their Shares. — In all cases the stockholder is liable to make good, in some form of proceeding, for the benefit of creditors of the corporation, whatever remains unpaid on his shares at their par value, according to the tenor or effect of the contract of subscription entered into by him or his assignor.[2] Beyond this his liability does not extend, except where it has been enlarged by constitutional or statutory provisions.[3]

§ 2930. This Rule under Various Constitutions and Statutes. — This rule is affirmed by various State constitutions and statutes, and where abrogated has sometimes been restored. Thus, under the Constitution of Missouri, as amended in 1870, a stockholder is not liable for a debt of the corporation if he has paid the whole amount of the stock subscribed or owned by him.[4] It is the rule with respect to manufacturing corporations in Iowa;[5] in Indiana, in respect of manufacturing and mining corporations,[6] and under a statute of Colorado.[7] And so in Maine, the remedy provided by statute against a stock-

[1] Lowry *v.* Inman, 46 N. Y. 119. That the obligation of certain stockholders of a bank to "pay all debts owing by the company" did not oblige them to pay its circulating notes, see Pollard *v.* Stockholders &c., 4 J. J. Marsh. (Ky.) 52. That a *bond*, with security given by the corporators of a savings bank to secure depositors therein, is not *capital stock*, see Huntington *v.* Savings Bank, 96 U. S. 388.

[2] Walker *v.* Lewis, 49 Tex. 123.

[3] Jackson *v.* Meek, 87 Tenn. 69, 71; *s. c.* 10 Am. St. Rep. 620; Spense *v.* Iowa &c. Construction Co., 36 Iowa, 407; Monaghan *v.* Hall, 18 La. Ann. 310; Wood *v.* Pearce, 2 Disn. (Ohio) 411; Toner *v.* Fulkerson, 125 Ind. 224; *s. c.* 25 N. E. Rep. 218.

[4] Schricker *v.* Ridings, 65 Mo. 208; Miley *v.* Parker, 7 Mo. App. 561.

[5] Warfield *v.* Marshall County Canning Co., 72 Iowa, 666; *s. c.* 2 Am. St. Rep. 263.

[6] Wheeler *v.* Thayer, 121 Ind. 64; *s. c.* 22 N. E. Rep. 972.

[7] Rev. Stat. Colo., ch. 18, § 12; 1 Mills Ann. St. Colo., 1891, § 486; Smith *v.* Londoner, 5 Colo. 365.

holder for corporate debts exists only against those who have subscribed for or agreed to take stock in the corporation, and have not paid for the same.[1] In like manner, a recent statute of Florida makes stockholders liable to creditors of corporations, organized under the general incorporation laws of the State, for unpaid subscriptions, and no further.[2]

§ 2931. **Exception as to the Necessity of a Call.** — This does not, however, imply that the same mode of collection must be pursued after insolvency as before. Thus, as already seen,[3] while the company is a going concern, a *call* by the board of directors may be a condition precedent to the right of action against the stockholder, because this is required by his contract; yet after insolvency this is dispensed with. A new trustee, so to speak, is substituted in the place of the directors, — generally a receiver appointed by a court of equity, — and the court makes an order as a substitute for a call by the directors, under which he brings actions at law against the several stockholders who do not respond, to collect their several proportions of the assessment thus made.[4] A stipulation in the contract of subscription that it shall be payable only on the call of the company is valid as between stockholders, but cannot be permitted to defeat the rights of creditors.[5] A provision in the charter that "the balance due on each share shall be subject to the call of the directors" does not give a stockholder the right, as between himself and the company, or as between himself and the company's creditors, to withhold payment of the balance due from him until the necessities of the company require payment in full for the shares subscribed.[6]

[1] Libby *v.* Tobey, 82 Me. 397; 19 Atl. Rep. 904.

[2] Fla. Act, May 31, 1887; Acts 1887, ch. 3729, No. 49, p. 96; Rev. Stat. Fla., § 2152. That the corporators of a corporation established under the Indiana act of 1852, authorizing the construction of levees and drains, are individually liable for the amounts respectively assessed on their several tracts of lands, but no further, for the payment of the corporate debts: Shaw *v.* Boylan, 16 Ind. 384.

[3] *Ante*, § 1702.

[4] *Post*, §§ 3385, 3537, 3549, 3754.

[5] Curry *v.* Woodward, 53 Ala. 371.

[6] Hill *v.* Merchants' Mut. Ins. Co., 134 U. S. 515, 526; *s. c.* 33 L. ed. 994;

§ **2932. Liability Exhausted by Payment.** — This liability is, of course, exhausted whenever the stockholder makes a valid *payment* for the shares, in conformity with principles already considered,[1] whether in money or property; and even where the *property* has been conveyed to the corporation, in payment of the shares of the respective shareholders, at more than its real value, this will not enable a creditor, who gives credit to the corporation with full knowledge of the facts, to charge a stockholder with his proportion of the difference between the real value of the land and the value at which it was conveyed to the corporation or to its trustee.[2] But where the stockholder has not made full payment, it is no answer to the suit of a creditor seeking to charge him to the extent of the balance, that the *interest* upon installments already paid should be allowed to extinguish the principal sum still due,[3] for this would convert his payment into a *loan*, so far as the rights of creditors are concerned.

§ **2933. Not Liable to Creditors when not Liable to Corporation.** — Except where elements of estoppel supervene, the general rule is that the stockholder is not liable to creditors after the insolvency of the corporation, unless the circumstances are such that he would have been liable to the corporation itself.[4] Thus, if a subscription to stock is made on a valid condition, — as that it shall not be binding unless the total amount is subscribed, — the corporation cannot, as we have already seen,[5] enforce the contract against the subscriber without first complying with the condition on its part; nor can its creditors,

7 Rail. & Corp. L. J. 442; 10 Sup. Ct. Rep. 589; affirming *s. c* 86 Mo. 466, which affirms 12 Mo. App. 148.

[1] *Ante*, ch. 26. To this statement an exception exists under the constitution of California (*ante*, § 2891), under which shares are assessable although full paid. Santa Cruz R. Co. *v.* Spreckels, 65 Cal. 193; Green *v.* Abietine Medical Co., 96 Cal. 322, 328.

[2] Bank of Fort Madison *v.* Alden, 129 U. S. 372; *s. c.* 9 Sup. Ct. Rep. 332.

[3] Wood *v.* Pearce, 2 Disn. (Ohio) 411.

[4] Union Sav. Asso. *v.* Seligman, 92 Mo. 635; *s. c.* 1 Am. St. Rep. 776; overruling Griswold *v.* Seligman, 72 Mo. 110; Burgess *v.* Seligman, 107 U. S. 20; First Nat. Bank *v.* Gustin Minerva &c. Co. (Minn.), 44 N. W. Rep. 198; 42 Minn. 327; *s. c.* 18 Am. St. Rep. 510; Robertson *v.* Sibley, 10 Minn. 323, 328.

[5] *Ante*, § 1332.

unless it appear that they have given credit to the corporation subsequently to the subscription, and on the faith of it.[1] So, where a subscriber to stock tendered the amount of his subscription to the corporation while it was solvent, and demanded a certificate, which was refused, it was held that he was not liable to the assignee in insolvency of the corporation.[2] But, as we have seen,[3] under many circumstances a release by the corporation of a subscriber would not be good as against its creditors. So, as already seen,[4] the individual liability of a stockholder of a corporation for a corporate debt is subordinate to the power of the directors to compromise the debt, or to forfeit the shares of the stockholder for non-payment of his dues to the corporation. After the directors have, in good faith, and within such power as the law regulating the corporation gives them, declared all the stock of a member forfeited for non-payment of assessments upon it, he cannot be held liable as a stockholder for corporate debts.[5]

§ 2934. Exception in Favor of Bona Fide Purchasers in Good Faith.—"Where a corporation issues shares as paid up, treats them as such, and, as such, puts them on the market, a person who innocently purchases them under the belief that they are paid up will not become chargeable with a liability to the creditors of the corporation in case the representations of the company should turn out to be false. Such a person is not required to suspect fraud or to institute inquiries where all seems fair and comformable to the requirements of the law."[6] It has even been held that a creditor's bill in equity to charge holders of nominally paid-up stock, on which nothing has been paid, is defective in not charging that defendants

[1] Hahn's Appeal (Pa.), 7 Atl. Rep. 482.

[2] Potts *v.* Wallace, 32 Fed. Rep. 272; *s. c.* 2 Rail. & Corp. L. J. 495.

[3] *Ante*, § 1517.

[4] *Ante*, § 1553.

[5] Mills *v.* Stewart, 62 Barb. (N. Y.) 444; *ante*, §§ 1550, 1792.

[6] Thomp. Stockh., § 135; quoted with approval in Johnson *v.* Lullman, 15 Mo. App. 55, 58; *s. c.* affirmed, 88 Mo. 567. The following cases support this text: Foreman *v.* Bigelow, 7 Cent. L. J. 430; *s. c.* 4 Cliff. (U. S.) 508; Keystone Bridge Co. *v.* McCluney, 8 Mo. App. 496; Young *v.* Erie Iron

took with notice.[1] But all these decisions assume that the stockholder sought to be charged purchased the shares after they had been issued and put on the market as paid-up shares. They have no application to the case of an original subscriber.

§ 2935. Exception where Shares have been Transferred in Pledge by the Corporation to the Shareholder. — On a general principle already stated, and in the absence of circumstances creating an equitable estoppel, the rule is that if it is agreed between the company and the taker of the shares that he shall take and hold them only as *collateral security* for money advanced by him to the corporation, this does not make him liable as a shareholder to creditors of the company. They acquire no higher rights as against him than the company had, and the law will not, out of tenderness to them, convert what was intended to be a security for him into a liability to them.[2] Nor does the fact that one to whom the shares of stock in a corporation have been issued, in pledge to secure an advance of money made by him to the corporation, *votes* at corporate meetings in respect of such shares, make him liable to its creditors after it becomes insolvent, in the view of one court.[3] So, a Canadian court has held that a savings bank, holding as pledgee bank shares which it had no right to own, and appearing as owner on the books of the pledgor bank, is not, as between itself and the bank whose shares it thus assumes to own, the *owner* of such shares, within the meaning of a statute relating to liability of owners of stock. The reason is that the bank whose shares are assumed to be thus held is bound to take notice of the governing statute, under which a savings bank cannot acquire and hold shares except as pledgee.[4]

Co., 65 Mich. 111; *s. c.* 31 N. W. Rep. 814; 8 West. Rep. 153. Compare Ives *v.* Citizens' Bank, 15 La. Ann. 83.

[1] Cleveland Rolling Mill Co. *v.* Texas &c. R. Co., 27 Fed. Rep. 250.

[2] Fisher *v.* Seligman, 7 Mo. App. 383; Union Sav. Asso. *v.* Seligman, 92 Mo. 635; *s. c.* 1 Am. St. Rep. 776; Matthews *v.* Albert, 24 Md. 537.

[3] Union Sav. Asso. *v.* Seligman, *supra.*

[4] Exchange Bank *v.* City &c. Sav. Bank, Montreal L. Rep., 6 Q. B. 196.

§ 2936. Illustration: Creditor of Corporation Holding Its Stock as Collateral Security and Voting It. — Thus, it has been held that where a corporation borrows money of a stranger, and issues its shares to him under an agreement that he shall hold them as collateral security for the loan, this does not render him liable as a stockholder to creditors of the corporation after it becomes insolvent, although, while the corporation was a going concern, he voted in respect of the shares at corporate elections, and elected himself a director.[1] The question of estoppel did not arise in the case, because the indebtedness in respect of which it was sought to make the pledgees liable accrued before they became such. As it appeared that the amount of stock issued to them in pledge was of the nominal value of $6,000,000, and that it gave them a controlling power over the corporation, and enabled them (they were a partnership) to elect one of their own members a director, had the indebtedness been created by them while thus in control of the corporation, the result must, on principle, have been different, unless the creditors of the corporation, at the time when the debt was created, were apprised of the precise nature of the contract between the corporation and the pledgees. The question turned upon the construction of the following statute: "No person holding stock in any such company, or executor, administrator, guardian, or trustee, and no person holding such stock as collateral security, shall be personally subject to any liability as stockholder of such company, but the person pledging such stock shall be considered as holding the same, and shall be liable as a stockholder accordingly; and the estates and funds in the hands of such executor, administrator, guardian, or trustee shall be liable in like manner and to the same extent as the testator, or intestate, or the ward, or person interested in such fund would have been, if he had been living and competent

[1] Burgess *v.* Seligman, 107 U. S. 20; Union Sav. Asso. *v.* Seligman, 92 Mo. 635; *s. c.* 1 Am. St. Rep. 766; overruling Griswold *v.* Seligman, 72 Mo. 110. This question first came before an appellate tribunal in Fisher *v.* Seligman, 7 Mo. App. 383, where it was held that, under the facts above stated, the pledgee of the corporate shares was not liable to be proceeded against, as a shareholder of the dissolved corporation by a creditor of the same, under the Missouri statute. On appeal to the supreme court, this decision was reversed (Fisher *v.* Seligman, 75 Mo. 13), Norton, J., dissenting. In the subsequent case of Union Sav. Asso. *v.* Seligman, 11 Mo. App. 142, the question again came before the St. Louis Court of Appeals. In the mean time the question had reached the Supreme Court of Missouri in a case appealed from another jurisdiction (Griswold v. Seligman, 72 Mo.

to act, and held the same stock in his own name."[1] This statute is said to be a copy of a statute of Maryland, which received the same interpretation on a similar state of facts. One Tieman had lent a corporation $2,000, and, as security, the corporation had issued a certificate of its stock to him, which, when issued, was absolute on its face, but upon which an indorsement was subsequently placed by the company, stating that it had been issued to him as collateral security. It was held that he was not liable to creditors as a stockholder.[2]

§ 2937. Liability of Pledgee of a Shareholder. — As we shall see hereafter, the general rule is that the liability of shareholders to creditors attaches to those who were *legal*, as contradistinguished from *equitable* shareholders,[3] that is to say, to him in whose name the shares stand on the books of the corporation, without reference to the *equities*, in respect of their ownership, which may subsist between him and third persons. The reason of this rule seems to lie in the inconvenience of investigating collateral equities between the shareholder and third persons, and in the danger of fraud which would arise if the rule were otherwise. Following out this rule, it has been held, in a case under the late bankrupt law, that a transferee of national bank shares is liable to the creditors of the bank as a stockholder, if the shares stand in his name on the books of the bank at the time of its suspension, notwithstanding he took the transfer, as security only, for a *debt* which has since been *paid*.[4] And so, where A. took stock as collateral security for a loan to B., at whose request he took a new certificate in his own name, surrendering the old, agree-

110), and that court had held that the pledgee was liable as a stockholder. The St. Louis Court of Appeals, in obedience to superior judicial authority, made the same ruling in the case of Union Sav. Asso. *v.* Seligman, *supra*. This case having been appealed to the supreme court, was reversed, that court receding from its former opinion upon the question. Union Sav. Asso. *v.* Seligman, 92 Mo. 635; *s. c.* 1 Am. St. Rep. 776. Sherwood, J., who wrote the opinion of the court in the case in 72 Mo., maintained his former opinion, and now dissented. For some unexplained reason—probably owing to the pendency of a motion for rehearing—the report of this last decision was withheld for three years.

[1] 1 Wag. Mo. Stat., p. 301, § 9; 1 Rev. Stat. Mo. 1889, § 2549.

[2] Mathews *v.* Albert, 24 Md. 537.

[3] *Post*, § 3193.

[4] Bowden *v.* Farmers' &c. Bank of Baltimore, 1 Hughes (U. S.), 807.

ing to sell the stock if he could, and for this purpose retained the stock *after the loan was paid*, and until after the corporation was insolvent and its property sold, when he returned the certificate to B., indorsed in blank, it was held that A. did not hold the stock as trustee after the loan was paid, but that, as to creditors of the corporation, he stood in the shoes of B., and was liable to them.[1] But the late Commission of Appeals of New York held that a person who received a transfer of the stock of another as *collateral security* for a debt due by the latter could not be held liable as a shareholder to a creditor, in a direct action given by a statute to the creditor against the shareholder, although his name appeared on the books of the company as absolute owner.[2] The opinion of Commissioner Earl proceeds on the analogy of the rule that it is competent to show that an assignment or conveyance, absolute in form, was intended only as a security.[3] He adds that "there is nothing in any statute which makes the books of the company the incontrovertible evidence of ownership of stock." It is doubtful whether this is to be regarded as more than an expression of opinion by a single judge. But however it is to be viewed, it is a plain judicial aberration. Nothing is better settled in the law of corporations than that the stockholder whose name appears on the books of the corporation with his own consent is absolutely bound in the character which he thus assumes, both to the company and to its creditors,[4] subject to an exception, which will now be stated.

§ 2938. In Case of Agreement by One Corporation to Assume Debts of Another.—Where two corporations make a valid agreement, by which the debt of one is assumed by the other, it is competent for them to rescind such agreement, rein-

[1] Erskine *v.* Loewenstein, 11 Mo. App. 595.

[2] McMahon *v.* Macy, 51 N. Y. 155, 161.

[3] Citing Hodges *v.* Tennessee &c. Ins. Co., 8 N. Y. 416; Despard *v.* Walbridge, 15 N. Y. 374; Sturtevant *v.* Sturtevant, 20 N. Y. 39; *s. c.* 75 Am. Dec. 371. This last case merely holds that the grantor in an absolute conveyance of land, not alleging fraud or mistake, cannot prove by parol that the grant was *in trust* for himself.

[4] Crease *v.* Babcock, 10 Met. (Mass.) 525, 545; Grew *v.* Breed, *Id.* 569.

state the liability of the corporation so discharged, and place the parties *in statu quo;* and the stockholders of the debtor corporation will become, under the Constitution of California,[1] personally liable for their respective proportionate shares of the liability so created or reinstated.[2]

§ **2939. Where the Corporation Engages in Other Business than that Authorized by Its Charter or Articles.** — Suppose a corporation is organized to carry on a certain business, or a business at a certain place, and that, after organizing, it never enters upon such business, or enters upon a business at a totally different place, and in the conduct of this unauthorized business enters into contracts, can its stockholders be held to personal liability thereon? In Massachusetts, where the doctrine is denied that the members of a corporation not legally organized are liable on its contracts as partners, it is held that, in such a case as above submitted, the stockholders are not liable as partners. When, therefore, a company was incorporated in Massachusetts for the purpose of manufacturing copper in Salem, in that State, and never manufactured any copper there, but engaged in the business of mining copper in Michigan, for the purpose of procuring copper ore to be sent to Salem to be manufactured, and its treasurer, with the approval of its directors, executed certain promissory notes for expenses incurred in such business of mining, it was held that an action could not be maintained upon the notes against the members; and the court said that this would be the case, although the corporation had never come into existence, and although the company may not have been liable on the notes as a corporation. The court, speaking through Metcalf, J., said: "But, admitting that the company is not liable on the notes as a corporation, yet it does not follow that its members are liable in a suit thereon. They may or may not be liable to the plaintiff in some form of action, according to circumstances. The members of a corporation may doubtless so manage its concerns as to render themselves personally respon-

[1] *Post,* § 3001.

[2] Borland *v.* Haven, 37 Fed. Rep. 394.

sible to those with whom they deal. If they, in the name of the corporation, give notes which the corporation is not bound to pay, and which it refuses to pay, they may, in many supposable cases, be held to indemnify the holders of such notes. The remedy against them, however, should not be by an action *on the notes*, but by an action of *tort*, as is the remedy against one who signs a note as agent for another without authority."[1] Directly opposed to this Massachusetts holding is a decision of the Supreme Court of Ohio, where certain persons were incorporated under the laws of that State to carry on the business of a *savings bank*. They never, in fact, entered upon the proper business of a savings bank at all, but went into a *general banking business*. In the course of this business they issued a certificate of deposit of the following tenor: "John G. Ridenour, Esq., has deposited in this bank one thousand one hundred and fifty dollars, payable to his order, on return of this certificate, six months after date, with interest at ten per cent per annum. (Signed) N. Tucker, cashier." In an action against the trustees of the bank, in which the petition counted directly upon this contract, it was held that they were *liable as partners*. The court regarded the question whether they were so liable as a *mixed question of law and fact*, and concluded that the evidence was consistent only with the conclusion that they had elected to abandon the agency which they had assumed under the charter of the savings bank, and had entered into a general banking business, which might lawfully be done as partners.[2] Somewhat similar is a decision of the Supreme Court of Minnesota. The

[1] Trowbridge *v.* Scudder, 11 Cush. (Mass.) 83, 86. To the proposition that the remedy against the individuals, in case it should turn out that there was no remedy against the corporation, would be *in tort*, and not in an action upon the contract, the court cited the following cases, which support the proposition: Ballou *v.* Talbot, 16 Mass. 461; *s. c.* 8 Am. Dec. 146; Jefts *v.* York, 4 Cush. (Mass.) 371; Jenkins *v.* Hutchinson, 13 Ad. & El. (N. S.) 744. It ought to be stated, however, that in some jurisdictions an action is allowed upon the contract itself; though in strict theory the action is an action to recover *damages* from the pretended agent who made the contract, on the ground of a *breach of an implied warranty of agency*. *Post*, §§ 2971, 4135; *ante*, §§ 218, 417, 418, 419, 424.

[2] Ridenour *v.* Mayo, 40 Ohio St. 9; *s. c.*, on a former appeal, 29 Ohio St. 138.

constitution of that State, as amended in 1872, imposes upon each stockholder in a corporation, except those organized for manufacturing or mechanical purposes, what is known as a "double liability," — that is to say, a personal liability to the amount of stock held or owned by him, — for the debts of the company. It is quite apparent that this provision would be wholly nugatory if men were allowed to organize corporations ostensibly for manufacturing or mechanical purposes, and then enter upon some other business, and thereby exempt their stockholders from this double liability. When, therefore, a corporation was organized, under the statute of that State relating to manufacturing corporations, with articles declaring the purpose of its organization to be that of manufacturing flour and feed; "also that of buying and selling, either on account of such corporation or on commission, and receiving, shipping, and storing of all kinds of grain, seeds, country and farm produce, lime, cement, coal, building material, hogs, sheep, horses, cattle, and any and all other articles of merchandise"; and generally to perform and transact all acts needful and proper for the prosecution of any of said business; and the corporation, in point of fact, engaged principally in storing, buying, and selling grain, building and operating grain warehouses, and, as incidental thereto, dealing in coal, lime, and cement, and the business of manufacturing formed but an insignificant portion of its real business; — it was held that its members were not exempt from the individual liability imposed by the constitutional provision.[1]

§ **2940. Where the Formation of the Corporation is Prohibited by Law or Public Policy.** — Where the statute law or the public policy of the State prohibits the formation of corporations for the carrying on of a certain kind of business, — for instance, the business of merchandising, — and nevertheless several coadventurers assume to organize a corporation to

[1] Mohr *v.* Minnesota Elevator Co., 40 Minn. 343; *s. c.* 41 N. W. Rep. 1074. Compare State *v.* Minnesota Thresher Man. Co., 40 Minn. 213. See, further, on this subject, *ante*, §§ 2859, *et seq.*

carry on that business, they will be liable as partners on the contracts made in their corporate name, and there will be no estoppel against the creditor contracting with them in their corporate name. It was so held in Texas, where a statute of that State allowing the organization of *mercantile corporations* had been repealed, and where certain persons, desiring to carry on the business of merchandising in that State as a corporation, caused themselves to be incorporated under the laws of Iowa, and then established their business in Texas. The court took the view that their organization in Iowa was a *fraud upon the laws* of Texas, and that no rule of comity would allow them to exist as a corporation in Texas contrary to the public policy of the State, as exhibited by the repeal of the statute permitting similar domestic corporations to be formed.[1]

§ 2941. Where the Business for Which the Corporation is Formed is Illegal. — The same principle applies where the *business* for which the corporation is formed is *prohibited by law or public policy.* Thus, it has been held that if several persons confederate together and have themselves incorporated, ostensibly for the purpose of engaging in the business of *buying and selling futures* in grain and produce, but with the real purpose and intention of *gambling* and *wagering* on the rise and fall in the prices of such products, the corporators will be individually liable for all sums illegally received by the managers of the corporation on wagering contracts,— the incorporation in such case being a mere cloak to cover the illegal transactions contemplated by the parties.[2]

§ 2942. Members of Religious Corporations may be Personally Liable. — Members of religious corporations may, by their own acts, make themselves personally responsible for

[1] Empire Mills *v.* Alston Grocery Co. (Tex. App.), 12 L. R. A. 366; *s. c.* 9 Rail. & Corp. L. J. 294; 15 S. W. Rep. 505; (affirming on rehearing, 15 S. W. Rep. 200; 33 Am. & Eng. Corp. Cas. 16.)

[2] McGrew *v.* City Produce Exch., 85 Tenn. 572; *s. c.* 4 Am. St. Rep. 771; 4 S. W. Rep. 38.

the payment of the corporate debts. Such corporations are anomalous in their nature; they have no capital stock, and yet have a distinct autonomy, at least for the purposes of litigation, which they not unfrequently persist in with an animosity which scandalizes the profession of religion. Courts of chancery deal with such bodies and their members in the best way they can to prevent a failure of justice.[1] When, therefore, the members of a religious corporation had squandered, in paying the expenses of litigation, a fund in their possession, a court of equity, in aid of a judgment creditor, decreed the individual members to make it good, so far as necessary to satisfy the complainant's demand.[2] Circumstances may also exist where the members of an unincorporated religious society will become personally liable to pay the pastor's salary, on the theory of having acquiesced in a settlement of it.[3]

§ **2943. Shareholders Personally Liable for Frauds Committed in Dealing with Corporate Assets.** — Whilst shareholders are not, in general, personally liable for the torts of the corporate body, yet they are personally liable for their own frauds or other torts, though committed under pretense of acting on behalf of the corporation.[4] Thus, persons exercising the powers of a corporation may, in their character as trustees, be held liable in a court of chancery for a fraudulent breach of their trust.[5] So, a stockholder in possession of the assets of a dissolved foreign bank is liable to satisfy the debt of a domestic creditor of such bank out of such assets, on the

[1] Lord Eldon, in Adley *v.* Whitstable Co., 17 Ves. 315, 324; Williams, C. J., in Bigelow *v.* Congregational Society of Middletown, 15 Vt. 370, 373.

[2] Bigelow *v.* Congregational Society of Middletown, 11 Vt. 283; *s. c.* on subsequent appeal, 15 Vt. 370.

[3] Sheehy *v.* Blake, 77 Wis. 394; *s. c.* 9 L. R. A. 564; 46 N. W. Rep. 537.

[4] Medill *v.* Collier, 16 Ohio St. 599. "They may have originally contracted debts in the name and upon the credit of the corporation, without any purpose of payment, or without any reasonable probability that payment could be made by the corporation; or they may have diverted all the funds of the corporation to their own use, in either case evincing a settled purpose of defrauding creditors." Redfield, J., in Whitwell *v.* Warner, 20 Vt. 425, 444.

[5] Colquitt *v.* Howard, 11 Ga. 556, 569.

ground that the latter has an equitable lien or charge upon them.[1] Stockholders are not liable for the debts of the corporation, either on account of any misrepresentations made by the company before incorporation, or for the non-disclosure of the company's indebtedness, on its application for a charter;[2] but to render them so liable for its debts on account of fraud, the creditors must show that they were induced to become creditors by something said or done by its members amounting to the perpetration of deceit upon them.[3]

§ **2944. Not Personally Liable for Securing to Themselves a Fraudulent Preference.** — But, it has been held — and, the writer thinks, on questionable reasoning — that the stockholders of a corporation who avail themselves of their superior advantages for the purpose of obtaining from the property of the corporation the payment of debts due to themselves, whether it be done by attachment or by assigning the property to a trustee by vote, are not thereby guilty of a *fraud in contemplation of law*, so as to render themselves liable personally for the debts of the corporation.[4] But the better opinion is, that the stockholders are liable *to the extent of the assets* thus fraudulently diverted into their hands.[5]

§ **2945. Not Personally Liable for Ultra Vires Debts.** — The so-called doctrine of *ultra vires* has been resorted to again and again, and often with success, to enable the corporation or its stockholders to escape the burden of performing their own contracts. One unavailing attempt was made to turn it the other way, and make the shareholders personally liable for debts contracted in a business in which the corporation had no power to engage. It was unsuccessful,[6] though public policy and honesty would have been better subserved by

[1] Tinkham *v.* Borst, 31 Barb. (N. Y.) 407.

[2] Matthewes *v.* Stanford, 17 Ga. 543.

[3] Sisson *v.* Matthews, 20 Ga. 848.

[4] Whitwell *v.* Warner, 20 Vt. 425.

[5] *Post*, §§ 2951, *et seq.*

[6] It was held that the purchase of goods by a corporation for the use of its employés, being within its charter, the fact that it sells these goods by retail to third persons is no ground

making the stockholders liable as partners for debts which the managers had no power under the governing statute to contract, than by allowing them to set up the wrong of their agents and servants in their own exoneration.[1]

§ 2946. Liability of a Sole Stockholder.—In theory of law, if all the stock passes into the hands of one person, so long as the corporate existence is maintained, his liability as a stockholder and his immunity from liability are the same as where there are many stockholders. It has been held, in conformity with this principle, that the sole stockholder of a bank, who has received its assets, is bound for its debts to *the extent of such assets*.[2]

for holding the stockholders liable as partners, even if such sales be *ultra vires*. Bearight *v.* Payne, 2 Tenn. Ch. 175.

[1] Compare *post*, § 3005; *ante*, § 2829.

[2] Robertson *v.* Conrey, 5 La. Ann. 297. See, also, *ante*, § 2844.

CHAPTER XLIV.

LIABILITY IN EQUITY ON THE GROUND THAT CAPITAL IS A TRUST FUND FOR CREDITORS.

SECTION
2951. Capital stock a trust fund for creditors.
2952. Including unpaid subscriptions.
2953. Recent qualifications of this doctrine.
2954. Stockholders withdrawing the capital of the corporation bound to make it good.
2955. Rule not varied by a public registration.
2956. This trust fund, how pursued by creditors.
2957. Grounds on which courts of equity proceed.
2958. Cases in which equitable relief is invoked.
2959. Grounds of equitable relief where stock is not paid in.
2960. Equity will compel directors to make assessments.
2961. Or make the assessments by its own methods.
2962. *Bona fide* dividends of profits.
2963. Grounds of equitable relief where stock is improperly divided.
2964. Creditors entitled to share ratably.

§ 2951. Capital Stock a Trust Fund for Creditors.—It is a favorite doctrine of the American courts[1] that the capital stock and other property of a corporation are to be deemed a trust fund for the payment of the debts of the corporation, so that the creditors have a lien or right of priority of payment on it, in preference to any of the stockholders of the corporation.[2]

[1] See *ante*, § 1569, *et seq.* I have not found a similar statement of doctrine in any English book of reports. The idea appears to have been invented by Mr. Justice Story in Wood *v.* Dummer, 3 Mason (U. S.), 308, decided in 1824.

[2] Story's Eq. Jur., § 1252; Wood *v.* Dummer, 3 Mason (U. S.), 308; Vose *v.* Grant, 15 Mass. 505; Spear *v.* Grant, 16 Mass. 9, 15; Baker *v.* Atlas Bank, 9 Met. (Mass.) 182, 192; Mumma *v.* Potomac Co., 8 Pet. (U. S.) 281, 286; Curran *v.* State, 15 How. (U. S.) 304; Tarbell *v.* Page, 24 Ill. 46; Ogilvie *v.* Knox Ins. Co., 22 How. (U. S.) 387; Payson *v.* Stoever, 2 Dill. (U. S.) 431; Sawyer *v.* Hoag, 17 Wall. (U. S.) 610; Burke *v.* Smith, 16 Wall. (U. S.) 390; New Albany *v.* Burke, 11 Wall. (U. S.) 96; Hightower *v.* Thornton, 8 Ga. 486; *s. c.* 52 Am. Dec. 412; Robison *v.*

§ 2952. **Including Unpaid Subscriptions.** — This capital stock, it has been said, consists of the money paid, or authorized or required to be paid in, as the basis of the business of the corporation and the means of conducting its operations.[1] It is an essential part of the doctrine of the preceding section that money agreed to be paid into the corporate treasury by the shareholders for their respective shares is a part of this trust fund.[2] When the liquidation of these unpaid subscriptions becomes necessary to pay the debts of the company, the

Carey, 8 Ga. 527, 530; Reid *v.* Eatonton Co., 40 Ga. 98, 102; 2 Am. Rep. 563; Slee *v.* Bloom, 19 Johns. 456; *s. c.* 10 Am. Dec. 273; Briggs *v.* Penniman, 8 Cow. 387, 395; *s. c.* 18 Am. Dec. 454; Mann *v.* Pentz, 3 N. Y. 415, 422; Hurd *v.* Tallman, 60 Barb. (N. Y.) 272; Bank of St. Mary's *v.* Powers, 25 Ala. 566, 612; Curry *v.* Woodward, 53 Ala. 371, 375; Smith *v.* Huckabee, 53 Ala. 191, 195; Paschall *v.* Whitsett, 11 Ala. 472; Allen *v.* Montgomery R. Co., 11 Ala. 437; Bassett *v.* St. Albans Hotel Co., 47 Vt. 313; Adler *v.* Milwaukee Patent Brick Co., 13 Wis. 57; Miers *v.* Zanesville Co., 11 Ohio, 274; *s. c.* 13 Ohio, 197; Henry *v.* Vermilion Co., 17 Ohio, 187; Moss *v.* Burroughs, 1 Woods (U. S.), 467; Union Mutual Life Ins. Co. *v.* Frearstone M. Co., 97 Ill. 537; *s. c.* 37 Am. Rep. 129; National Trust Co. *v.* Miller, 33 N. J. Eq. 155; Union National Bank *v.* Douglass, 1 McCrary (U. S.), 86; Morgan County *v.* Allen, 103 U. S. 498; State *v.* Commercial State Bank, 28 Neb. 677; *s. c.* 44 N. W. Rep. 998; Marshall Foundry Co. *v.* Killian, 99 N. C. 501; *s. c.* 6 Am. St. Rep. 539; 6 S. E. Rep. 80; Beck *v.* Henderson, 76 Ga. 360; Crandall *v.* Lincoln, 52 Conn. 73; *s. c.* 52 Am. Rep. 560; Union Nat. Bank *v.* Douglas, 1 McCrary (U. S.), 86; Main *v.* Mills, 6 Biss. (U. S.) 98; Kenton Furnace Co. *v.* McAlpin, 5 Fed. Rep. 743; Payne *v.* Bullard, 23 Miss. 88, 90; *s. c.* 55 Am. Dec. 74. In Tinkham *v.* Borst, 31 Barb. (N. Y.) 407, the court proceeded on the idea that creditors have an equitable *lien* upon the assets of a dissolved corporation in the hands of one of its members.

[1] Farrington *v.* Tennessee, 95 U. S. 679, 686.

[2] So held in nearly all the cases cited in the preceding section. See *ante*, § 1573; also Marsh *v.* Burroughs, 1 Woods (U. S.), 469; Winans *v.* McKean &c. Co., 6 Blatchf. (U. S.) 221; Sanger *v.* Upton, 91 U. S. 56, 61; Morgan County *v.* Allen, 103 U. S. 498, 509; Ogilvie *v.* Knox Ins. Co., 22 How. (U. S.) 380; Sawyer *v.* Hoag, 17 Wall. (U. S.) 610; *s. c.* Myer Fed. Dec., § 152; Shickle *v.* Watts, 94 Mo. 410; Gogebic Investment Co. *v.* Iron Chief Mining Co., 78 Wis. 427; *s. c.* 23 Am. St. Rep. 417; Marshall Foundry Co. *v.* Killian, 99 N. C. 501; *s. c.* 6 Am. St. Rep. 539, 542; Adler *v.* Milwaukee Patent Brick Co., 13 Wis. 57, 60; Richardson *v.* Green, 133 U. S. 30; Hightower *v.* Thornton, 8 Ga. 486, 495; *s. c.* 52 Am. Dec. 412; Allen *v.* Montgomery R. Co., 11 Ala. 437. But a bond with security, given by the corporators of a savings bank to secure depositors therein, is in no sense capital stock of the company. Huntington *v.* Savings Bank, 96 U. S. 388.

stockholders cannot be allowed to refuse the payment of them, unless they show such an equity as would entitle them to a preference over the creditors, if the capital had been paid in cash.[1]

§ 2953. Recent Qualifications of this Doctrine. — It was formerly the doctrine of the Supreme Court of the United States,[2] and it is still the doctrine of the British House of Lords,[3] that this trust fund extends to whatever sum, less than the par value of his shares, the shareholder *ought to pay*, although it may have been agreed between him and the corporation that he shall not pay it.[4] There is not much room to doubt the soundness of the conclusion that where the rights of creditors are not concerned, an agreement between the corporation and its shareholders that they are to have their shares upon the payment of a sum less than the par or nominal value will *estop* the corporation from maintaining an action to collect the balance.[5] But it was formerly supposed, in conformity with the holding of the Supreme Court of the United States just referred to,[6] that a subscriber to the shares of a corporation could be compelled to pay, if necessary to liquidate its debts, the entire par value of his shares, no matter what agreement he may have made with the corporation in respect of their payment, at the time of his subscription or afterwards. But this doctrine, as already seen,[7] has been recently modified by the Supreme Court of the United States, to the extent of holding that in the absence of

[1] Ogilvie *v.* Knox Ins. Co., 22 How. (U. S.) 380.

[2] *Ante*, §§ 1567, 1568.

[3] Ooregum Gold Mining Co. *v.* Roper [1892], A. C. 125, H. L.

[4] The doctrine of the English case is not strictly that stated in the text, though it amounts to the same thing. The English judges do not speak of the capital stock of a corporation being a "trust fund" for its creditors; but the case cited from the House of Lords holds that, when it is necessary to liquidate the debts of the company, the shareholder must pay for his shares in full, — that is, he must pay up their par or nominal value, although it may have been agreed between him and the company, at the time when he purchased the shares, that he should not be required to pay in full.

[5] Kenton Furnace &c. Co. *v.* McAlpin, 5 Fed. Rep. 737, 743.

[6] Upton *v.* Tribilcock, 91 U. S. 45.

[7] *Ante*, § 1562, *et seq.*

circumstances creating an *equitable estoppel* in favor of the creditor of the corporation and against the shareholder, the latter cannot be compelled to pay, even for the purpose of liquidating the debts of the corporation after its insolvency, anything beyond what the corporation agreed with him to accept as full payment. This is tantamount to holding that so far as the rights of creditors, who became such prior to the issuing of the shares, are concerned, whatever the corporation agreed with the shareholder to accept as payment is payment, — even though it agreed to give away the shares or to issue them as a *bonus*, or in consideration of some past benefit, it is to be deemed payment. This lifts the obligation of the shareholder to pay the par value of his shares, even for the purpose of liquidating the debts of the corporation, out of the category of principles of *public policy*, and lets it down to the mere doctrine of an equitable *estoppel*. The meaning is, that except in cases where creditors have been deceived and misled by the corporation pretending to have a capital which it has not, a creditor can enforce no right as against a shareholder greater than the corporation itself could enforce against him. For example, it is held in a recent case applying the new doctrine, that the rights of creditors to compel the holders of "*bonus stock*" to pay for it, contrary to their actual agreement with the corporation, does not rest on any *implied contract*, or upon this "trust fund" doctrine, but upon the ground of *fraud* in the misrepresentation as to the actual amount of capital, upon the faith with which persons have dealt with the corporation and given it credit.[1] Another modification of this doctrine will arrest the attention in a future chapter. It is a necessary part of the doctrine that the capital stock of a corporation is a *trust fund for all its creditors*, — that is to say, for a ratable distribution among all its creditors who stand on an equal footing; as in a distribution in bankrupty, preserving to lien creditors their liens, and distributing the remainder among the unsecured creditors *pro rata*. But

[1] Hospes *v.* Northwestern Man. etc. Co., 48 Minn. 174; *s. c.* 31 Am. St. Rep. 637; 15 L. R. A. 470; 45 Alb. L. J. 277; 36 Am. & Eng. Corp. Cas. 206; 50 N. W. Rep. 1117.

we shall see that several of our State courts have fallen into the unfortunate and grossly inequitable doctrine that it is competent for a corporation, even in contemplation of a suspension by reason of insolvency, to *prefer particular creditors* in the final distribution of its assets.[1] A concession of this power seems to sweep the trust fund doctrine entirely out of existence, and to place the assets of the corporation, in respect of the rights of its creditors, in exactly the same position as the assets of a natural person. Such is the avowed doctrine of the Supreme Court of Minnesota in a recent case, where it is reasoned that the capital of a corporation is its own property, which it may use and dispose of (if not prohibited by its charter) the same as a natural person, and is not held in trust for creditors, except in the sense that there can be no distribution of it among stockholders without provision for the payment of corporate debts, and that any disposition of it in fraud of creditors is void; and that in this respect there is no distinction between unpaid and paid capital, or between "stock subscriptions" and any other assets of the corporation;[2] though there may not be much difference after all, except in point of words, between the views of this court and those of Mr. Justice Story, the inventor of the trust fund doctrine.

§ **2954. Stockholders Withdrawing the Capital of the Corporation Bound to Make It Good.** — The doctrine, so much enlarged upon, that the capital stock of a corporation is a trust fund for its creditors, implies that a stockholder will not be permitted, as against creditors of the corporation, to withdraw any part of its assets without consideration.[3] Nor have the directors, as trustees of this fund, any *power*, except in the way of *bona fide* compromises, to *release* a subscriber to the fund, either as against creditors or as against other stockholders.[4] Thus, if a holder of shares makes an arrangement with the company, by which he receives full-paid scrip for a part of his subscrip-

[1] *Post*, ch. 146.

[2] Hospes *v.* Northwestern Man. etc. Co., 48 Minn. 174; *s. c.* 31 Am. St. Rep. 637; 15 L. R. A. 470; 45 Alb. L. J. 277; 36 Am. & Eng. Corp. Cas. 206; 50 N. W. Rep. 1117.

[3] Lewis *v.* Robertson, 13 Smedes & M. (Miss.) 558, 562.

[4] Rider *v.* Morrison, 54 Md. 429; *ante*, § 1553.

tion, and is released as to the residue, he may be held by creditors to the obligation of paying in full according to his original undertaking.[1] So, if a corporation issues *new stock* under a scheme by which sixty per cent of its par value is to be accepted as full payment, the sharetaker will be bound to make good the other forty per cent in the event of its insolvency.[2] So, creditors may charge the stockholders in respect of *dividends* fraudulently declared and paid when there is nothing to divide.[3] But dividends declared and paid in good faith out of the earnings of the corporation, while it is solvent and prosperous, cannot be pursued in the hands of its stockholders by its creditors, when, in consequence of misfortune, it afterwards becomes insolvent, and subjected to its liabilities.[4] A decision rendered by that eminent equity judge, Sir George Jessel, M. R., embodies a forcible expression of the same doctrine. He was dealing with the right of creditors of an insolvent company, represented by the official liquidators, to have the directors repay to the official liquidators, for their benefit, certain sums which the directors had caused to be paid to the shareholders as *interest*, out of the capital of the company, there being no *profits*. In his view, "the substance of the right" was this: "The limited company trades upon the representation of being a limited company, with a paid-up capital to meet its liabilities. It is wholly inconsistent with that representation that the company, having its capital paid up, should pay it back to its shareholders, and give the creditors nothing at all."[5]

§ 2955. Rule not Varied by a Public Registration. — Neither is this rule, nor the reasons on which it rests, varied by the fact that the charter of incorporation, or the general law, requires a *public registration* of a certificate of the amount

[1] Mann *v.* Pentz, 2 Sand. Ch. (N.Y.) 257. See also Payne *v.* Bullard, 23 Miss. 88; *s. c.* 55 Am. Dec. 74; *ante*, § 1512.

[2] McAvity *v.* Lincoln Pulp &c. Co., 82 Me. 504; 20 Atl. Rep. 82.

[3] *Ante*, § 2152.

[4] Reid *v.* Eatonton Man. Co., 40 Ga. 98; *s. c.* 2 Am. Rep. 563. The insolvency in this case grew out of the destruction of the property of the corporation during the Civil War.

[5] Re National Funds Assurance Co., 10 Ch. Div. 118, 127.

of stock actually paid in. Any one dealing with the company would indeed know from this public record the amount paid in; but he would also know, from the act of incorporation, or from the general law, that the balance was at all times subject to call of the directors; and, if he considered them honest men, he would believe that they would call in the remaining installments whenever the wants of the company might require it.[1]

§ 2956. **This Trust Fund how Pursued by Creditors.** — The capital paid in, together with its accretions, usually constitutes the visible and tangible assets of the corporation, subject to execution at law upon judgments rendered; or, if put beyond the reach of execution by fraudulent transfers or concealments, subject to be pursued by a creditor's bill, or (under the codes) by proceedings supplementary to execution, as in other cases of fraudulent conveyances. As will be seen hereafter, funds which consist of (1) capital subscribed but not paid in; (2) capital subscribed and paid in, but improperly divided among the shareholders,[2] or converted by particular shareholders, can in general be *reached only by appropriate proceedings in equity.*[3]

§ 2957. **Grounds on Which Courts of Equity Proceed.** — In affording relief to creditors of corporations, on this ground, courts of equity proceed on the familiar principle that whoever is found in possession of a trust fund, under circumstances which charge him with knowledge of the trust, is bound to account as trustee to those beneficially interested in such fund.[4] Stockholders in a corporation are conclusively charged with notice of the trust character which attaches to the capital stock. As to it they cannot occupy the *status* of innocent purchasers, but they are to all intents and purposes

[1] Ward *v.* Griswoldville Man. Co., 16 Conn. 593, 600.

[2] *Ante*, § 2152, *et seq; post*, § 2963.

[3] See Wallworth *v.* Holt, 4 Mylne & C. 619; Society of Practical Knowledge *v.* Abbott, 2 Beav. 559. Therefore, there was no remedy in Massachusetts until the system of equity was adopted by statute. Vose *v.* Grant, 15 Mass. 505; Spear *v.* Grant, 16 Mass. 9.

[4] Adair *v.* Shaw, 1 Schoales & L. 262; Hill *v.* Simpson, 7 Ves. 152; Wood *v.* Dummer, 3 Mason (U. S.), 312; Bank of St. Mary's *v.* St. John, 25 Ala. 566, 620; Calhoun *v.* King, 5 Ala. 523;

privies to the trust. Whenever they have in their possession any of this trust fund, they hold it *cum onere*, subject to all the equities which attach to it.[1] Not only that: they stand in such a relation of *privity* with the corporation that their dealings with it will be subjected to *close scrutiny* where the rights of its creditors are involved.[2] If, therefore, a stockholder usurps the functions of the board of directors of the corporation, and takes possession of the trust property, and converts it to his own use as his own individual property, he will be held to account as trustee *ex maleficio* for all the property coming into his possession.[3] Nor will any sort of manipulation of the trust property by the shareholders place it beyond the reach of a court of equity, which deals with substance, and not merely with form, so long as they do not get it into the hands of innocent purchasers for value. Thus, it has been held that a shareholder, owning practically all the capital stock of a railroad, who sells the road, in order to cut off general creditors and benefit himself at their expense, will be held to account to the creditors of the corporation, either for the property itself or its proceeds.[4] So, it has been well said that the stockholders of a corporation cannot buy property in its name, and on credit, and then form a new corporation in which their interests are the same as in the old, and based on no new consideration, and, by transferring the property to the new corporation, escape liability to the vendor and creditors, at least to the value of the property.[5]

Panhandle Nat. Bank *v.* Emery, 78 Tex. 498; *s. c.* 15 S. W. Rep. 23.

[1] Wood *v.* Dummer, 3 Mason (U.S.), 313; Adler *v.* Milwaukee Patent Brick Co., 13 Wis. 57, 62.

[2] See the observations of Mr. Justice Miller upon this subject in Sawyer *v.* Hoag, 17 Wall. (U. S.) 610; *s. c.* Myer Fed. Dec., § 156; citing Lawrence *v.* Nelson, 21 N. Y. 158.

[3] Cleveland Rolling Mill Co. *v.* Crawford (Ill. C. C.), 9 Rail. & Corp. L. J. 171.

[4] Cleveland Rolling Mill Co. *v.* Crawford (Ill. C. C.), 9 Rail. & Corp. L. J. 171.

[5] Hancock *v.* Holbrook, 40 La.Ann. 53; *s. c.* 3 South. Rep. 351. So, in sequestration proceedings against an insolvent corporation, a creditor became a party, and filed a complaint against stockholders of the corporation to compel them to account for certain stock in another corporation which belonged to the defendant corporation, and which was alleged to have been assigned to defendant stockholders, and distributed among

§ 2958. Cases in Which Equitable Relief is Invoked. — From what has been already stated, it is obvious that there are three cases in which equitable relief may be invoked: 1. Where there has been a fraudulent conveyance of trust property; 2. Where stockholders are indebted to the corporation on account of stock subscribed for and not paid in; 3. Where there has been a dividend in liquidation, or other distribution of the capital stock among the members, leaving creditors unpaid. The first of these cases rests on the same footing as any other fraudulent conveyance, and will not, therefore, claim special attention in this work.[1]

§ 2959. Grounds of Equitable Relief where Stock is not Paid in. — A court of equity will never allow a trust to fail on account of the failure or refusal of a trustee to perform his duty.[2] When, therefore, the creditors of a corporation are unable to obtain satisfaction in the ordinary mode, if the stockholders are indebted to the corporation on account of subscriptions made by them to the capital stock, and the board of directors fail or refuse to raise the money to pay such debts, by making and enforcing against the members the necessary assessments, a court of equity will interfere, and either compel the directors to perform this duty, or (according to the modern practice) perform it by its own proper officers.[3] "The rights

them, without their paying anything therefor except their own stock in the defendant corporation, which they surrendered, and which the officers of defendant corporation "pretended to cancel and retire." The complaint then alleged that such acts were without authority from defendant corporation or its directors, but were contrary to law, and null and void. It was held that the complaint stated a cause of action for at least a technical conversion of the certificates of stock, and that a demurrer thereto was properly overruled. McKusick *v.* Seymour, Sabin & Co., 48 Minn. 172; *s. c.* 50 N. W. Rep. 1116. See, also, Horner *v.* Carter, 11 Fed. Rep. 362.

[1] See, however, Wright *v.* Petrie, 1 Smedes & M. Ch. 282; Hightower *v.* Mustian, 8 Ga. 506; Allen *v.* Montgomery R. Co., 11 Ala. 437; Nathan *v.* Whitlock, 9 Paige (N. Y.), 152; Chicago &c. R. Co. *v.* Third Nat. Bank, 134 U. S. 276; *s. c.* 33 L. ed. 900; 10 Sup. Ct. Rep. 550.

[2] Bank of St. Mary's *v.* St. John, 25 Ala. 609; Attorney-General *v.* Aspinall, 2 Mylne & C. 613, 625; Attorney-General *v.* Kell, 2 Beav. 575; Attorney-General *v.* Leicester, 7 Beav. 176.

[3] Adler *v.* Milwaukee Patent Brick Co., 13 Wis. 57, 62; Ward *v.* Griswoldville Man. Co., 16 Conn. 593, 601; Henry *v.* Vermilion &c. R. Co., 17

of creditors being superior, and partaking somewhat of the character of a lien, equity will regard and work them out by the same means by which the corporation itself should have done so."[1] The power conferred on the board of directors of a corporation to call in the installments due upon subscriptions for shares is not a *discretionary* power, such as is beyond the interference of a court of justice.[2] On the contrary, this discretion is merely *modal*, relating to the time and manner of making the payments. When the wants of the company require these payments, it becomes the *duty* of the directors to cause them to be made, as much so as to require the payment of debts due the company; and it is not discretionary with the directors to say whether the debts of the company shall be paid or not when they have the means at command.[3] "As the individual corporators are not themselves personally responsible for the contracts of the corporation, there is no responsibility anywhere if the capital stock is not a fund answerable to creditors; and it would seem to make no difference in the right whether this capital stock or fund existed in property or equitable assets. Nor can it vary the right if the Legislature, instead of requiring the stock to be paid in, has permitted the corporation to call for it as their necessities or the convenience of stockholders may require. In the latter case the subscription is a debt which the corporation may call for; and if debts are contracted beyond the assets in hand, it would be most inequitable to neglect or refuse to make the call so as to discharge the debt. It is on this obvious principle that a court of equity assumes jurisdiction and compels the corporation and stockholder to do that which justice

Ohio, 187; Ogilvie *v.* Knox Ins. Co., 22 How. (U. S.) 380; Marsh *v.* Burroughs, 1 Woods (U. S.), 463.

[1] Adler *v.* Milwaukee Patent Brick Co., 13 Wis. 57, 62, *per* Dixon, C. J.

[2] See The Queen *v.* Victoria Park Co., 1 Ad. & Ell. (N. S.) 292, *per* Lord Denman, C. J.; Marsh *v.* Burroughs, 1 Woods (U. S.), 463, *per* Bradley, J.

[3] Ward *v.* Griswoldville Man. Co., 16 Conn. 593, 601. The court distinguishes Catlin *v.* Eagle Bank, 6 Conn. 233. The question there was whether an insolvent corporation might refuse to pay one creditor in preference to the others. Here, said the court, the question is whether a corporation may refuse to pay any of its creditors.

requires,—that is, to discharge the debt to the extent that the capital stock remains in the hands of the stockholder."[1] Views similar to the foregoing will be found expressed in several other cases.[2]

§ 2960. Equity will Compel Directors to Make Assessments.—This doctrine takes root in the chancery case of Salmon *v.* Hansborough Co., decided in the reign of Charles II.,[3] the authority of which has been recognized by several American courts,[4] and seems to rest on the soundest principles.

§ 2961. Or Make the Assessments by Its Own Methods.—In the American cases the form of relief has varied somewhat. In the leading case in New York, certain stockholders were found liable in respect of unpaid subscriptions, and they were directed to pay *to the complainant* the amount so unpaid, or so much thereof as should be necessary to discharge his debt, and that they jointly pay the costs.[5] In a later case in the same State, the decree, as modified by the court for the correction of errors, found that the company was formed and dissolved as stated in the bill; that the appellants were stockholders as charged, and liable to discharge the respondent's debt to the extent of their respective shares of stock, or so much as might be necessary for the discharge. The decree then referred it to a master, to ascertain and report the amount of the debt, and the proportions with which each of the appellants were chargeable.[6] Several recent cases growing out of the failure of a Virginia corporation, where a court of

[1] Allen *v.* Montgomery R. Co., 11 Ala. 437, 449, *per* Goldthwaite, J.

[2] Henry *v.* Vermilion &c. R. Co., 17 Ohio, 187; Ogilvie *v.* Knox Ins. Co., 22 How. (U. S.) 380, 387, in which Mr. Justice Grier said that a bill filed for this purpose was in the nature of an *attachment*, in which the stockholders are called on to answer as *garnishees* of the principal debtor.

[3] Salmon *v.* Hamborough Co., 1 Cas. Ch. 204; *s. c.* 1 Kyd on Corp. 273.

[4] Hightower *v.* Thornton, 8 Ga. 486, 493; *s. c.* 52 Am. Dec. 412; Briggs *v.* Penniman, 8 Cow. 387, 396; Slee *v.* Bloom, 19 Johns. 456, 484; *s. c.* 10 Am. Dec. 273.

[5] Slee *v.* Bloom, 19 Johns. 456, 484; *s. c.* 10 Am. Dec. 273.

[6] Briggs *v.* Penniman, 8 Cow. 387, 397; *s. c.* 18 Am. Dec. 454.

equity appointed a receiver and ordered an assessment, illustrate the principle under discussion.[1]

§ **2962. Bona Fide Dividends of Profits.** — This principle does not extend so far as to require stockholders to surrender, for the benefit of creditors, *bona fide* dividends of profits declared and distributed at a time when the company was solvent and prosperous.[2] The reasons which support this rule are very clear. The profits and accretions springing from the use of the capital stock of a corporation form no part of the capital stock itself, and hence no part of the stake on which the company acquires credit.[3] Persons doing business know that these profits, although they may be accumulated in the form of what is called a surplus fund, and used by the company in its business, are always subject to be distributed in dividends, at the will of the board of directors. Whilst, therefore, the existence of a large surplus, subject to executions on judgments against the corporation, may, in the opinion of persons dealing with it, render its continued solvency more probable, yet this constitutes no reason why such a fund, fairly divided among the shareholders, leaving the company able to meet its existing obligations, should, in the event of its subsequent insolvency, be pursued by its creditors. But a division of such assets at a time when the corporation was insolvent, or in contemplation of insolvency, would partake of the nature of a conveyance in fraud of creditors, and a creditor's bill would lie to reach and subject them to execution.[4] Such a bill would also be sustained on the ground that strict trusts are at all times open to the examination of a court of

[1] *Post*, § 3247, *et seq.;* § 3641, *et seq.*

[2] Reid *v.* Eatonton Co., 40 Ga. 98; *s. c.* 2 Am. Rep. 563. Upon the question when dividends may properly be declared, see *ante*, § 2152, *et seq.*

[3] *Ante*, § 2157; State *v.* Morristown Fire Asso., 23 N. J. L. 195; Barry *v.* Merchants' Exchange Co., 1 Sand. Ch. (N. Y.) 280, 303; Hightower *v.* Thornton, 8 Ga. 486, 500; *s. c.* 52 Am.Dec. 412, *per* Lumpkin, J. "They [the stockholders] have the benefit of all the *profits* made by the establishment, and cannot take any portion of the fund [the capital stock] until all other claims on it are extinguished." Story, J., in Wood *v.* Dummer, 3 Mason (U. S.), 311.

[4] Bank of St. Mary's *v.* St. John, 25 Ala. 566, 609.

equity, and that such a court will never refuse to bring before it an unfaithful trustee, whom it will compel both to discover the fund belonging to the trust, and to account for its mis management and misapplication.[1] For when a corporation becomes insolvent, all its assets—not alone its capital stock—become impressed with the character of a trust fund for the security of creditors.[2] Moreover, such misconduct renders the directors personally liable under statutes hereafter considered.[3]

§ 2963. Grounds of Equitable Relief where Stock is Improperly Divided. — Upon grounds already stated, no stockholder in a corporation can entitle himself to a *dividend* or share *of the capital stock* until all the debts of the corporation are paid; though, of course, dividends *of profits* may be lawfully made where there are debts unpaid, provided sufficient assets are received to pay them as they mature.[4] If the capital stock should be divided, leaving any debts unpaid, every stockholder receiving his share of the capital stock would in equity be held liable *pro rata* to contribute to the discharge of such debts out of the fund in his own hands.[5] Such property is held affected with a trust, primarily, for the creditors of the company, and subject to their rights; secondarily, for the stockholders, in proportion to their interest therein. As to it the creditors have a prior exclusive equity. In other words, the stockholders have no right to any thing but the *residuum* of the capital stock, after the payment of all the debts of the corporation. If, before all of such debts are discharged, they take into their hands any of the funds of the corporation, they hold them subject to an equity which it is against conscience to resist.[6] Accordingly, when the property has been

[1] Bank of St. Mary's *v.* St. John, 25 Ala. 566, 609.

[2] *Ibid.*

[3] *Post*, § 4178; *ante*, § 2155.

[4] See next section.

[5] 2 Story Eq. Jur., § 1252; Wood *v.* Dummer, 3 Mason (U. S.), 308; Vose *v.* Grant, 15 Mass. 505, 517, 522; Spear *v.* Grant, 16 Mass. 9, 15; Curran *v.* Arkansas, 15 How. (U. S.) 304; Reid *v.* Eatonton Co., 40 Ga. 98, 104; *s. c.* 2 Am. Rep. 563; Bank of St. Mary's *v.* St. John, 25 Ala. 566. See also Schley *v.* Dixon, 24 Ga. 273; *s. c.* 71 Am. Dec. 121; Tinkham *v.* Borst, 31 Barb. (N. Y.) 407.

[6] Wood *v.* Dummer, 3 Mason (U.S.), 321.

divided among the stockholders, a judgment creditor, after the return of an execution against the corporation unsatisfied, may maintain a creditor's bill against a single stockholder,[1] or against as many stockholders as he can find within the jurisdiction,[2] to charge him, or them, to the extent of the assets thus diverted; and it is immaterial whether he got them by fair agreement with his associates, or by an act wrongful as against them. It has been held that the sense in which the assets of a corporation are a trust fund for its creditors is such that if, before the payment of its debts, its assets are distributed to its shareholders, or deposited in trust for such distribution, and if thereafter the corporation passes into the hands of a receiver, he, as the representative of its creditors, will have *an equitable lien* upon the assets so distributed or deposited, after the payment of any debts which may remain, or of the costs of the receivership.[3]

[1] Hastings *v.* Drew, 76 N. Y. 9; Bartlett *v.* Drew, 57 N. Y. 587; affirming *s. c.* 4 Lans. (N. Y.) 444; 60 Barb. (N. Y.) 648.

[2] Wood *v.* Dummer, 3 Mason (U. S.), 308.

[3] This is well illustrated by the case of Heman *v.* Britton, 88 Mo. 549 (reversing *s. c.* 14 Mo. App. 121), which presents a case where this principle was worked out on a complicated state of facts. The St. Louis Court of Appeals, whose judgment was reversed, ruled, and, it would seem, with more propriety, that, the debts of the corporation being paid, the assets thus placed in trust for distribution could not be subjected to the payment of the costs of the receiver's administration. In fact, the receivership seems to have been an abuse, as there were no corporate assets to administer, and no corporate debts to pay. Very close to this doctrine lies a decision rendered by that eminent equity judge, Sir George Jessel, M. R., in a case where the directors of a company which had made no *profits*, caused, from time to time, *interest* to be paid to the shareholders out of the capital. He held that this was a breach of trust, such as made the participating directors, after the suspension of the company, jointly and severally liable to repay the sums thus improperly paid out, on an application of its official liquidator, under the following statute: "Where, in the course of the winding up of any company under this act, it appears that any past or present director . . . . has misapplied . . . . or become liable or accountable for any moneys of the company, or been guilty of any misfeasance, or breach of trust, in relation to the company, the court may, on the application of any liquidator, or of any creditor or contributory of the company, ... examine into the conduct of such director, ... and compel him to repay any moneys so misapplied or retained, or for which he has become liable or accountable." Re National

§ 2964. Creditors Entitled to Share Ratably. — The mere statement that the capital stock of a corporation is a trust fund in equity for its creditors carries with it the conclusion that all the beneficiaries of the trust — *all* the creditors — are entitled to share ratably in its distribution, according to the principles upon which courts of equity proceed in the distribution of equitable assets;[1] and such is the rule, with confusing exceptions[2] growing out of theories of the right of a corporation to prefer its creditors, which will be hereafter discussed.[3]

Fund Assurance Co., 10 Ch. Div. 118. But this remedy is available *only in equity;* and, therefore, before the introduction of the system of equity into Massachusetts, judicial remedies were so limited that, where the capital stock of a bank was divided after its charter had expired, so that no funds were left to pay its debts, an action would not lie against an individual stockholder who had received his proportion of the dividends. Vose *v.* Grant, 15 Mass. 505; Spear *v.* Grant, 16 Mass. 9. Compare Gifford *v.* Thompson, 115 Mass. 478. In a statute of Iowa (Iowa code, § 1072), making stockholders liable when corporate funds have been diverted to payments of dividends, leaving insufficient funds to meet the liabilities, the word "funds" means *resources*, and not merely cash on hand, and the word "liabilities" means debts the payment of which can be enforced, and does not include the capital stock of the corporation. Miller *v.* Bradish, 69 Iowa, 278.

[1] Story Eq. Jur., § 544; Rieper *v.* Rieper, 79 Mo. 352, 360; Heiman *v.* Fisher, 11 Mo. App. 275, 280; Purdy *v.* Doyle, 1 Paige (N. Y.), 558; Morrice *v.* Bank of England, Cas. *temp.* Talbot, 218. See, further, as to the general rule, Codwise *v.* Gelston, 10 Johns. (N. Y.) 507, 522; M'Dermutt *v.* Strong, 4 Johns. Ch. (N. Y.) 687; Atlas Bank *v.* Nahant Bank, 3 Met. (Mass.) 581.

[2] Wetherbee *v.* Baker, 35 N. J. Eq. 501.

[3] *Post,* Ch. 146. That the *directors* may become *personally liable* for a breach of this trust and duty of distributing ratably, see Graham *v.* Hoy, 38 N. Y. Super. 506.

CHAPTER XLV.

LIABILITY BEFORE ORGANIZATION COMPLETE AND CAPITAL PAID IN.

SECTION
2968. Preliminary.
2969. Until legal organization, coadventurers liable as partners.
2970. What evidence necessary to charge a person as such a partner.
2971. Theories on which members have been held liable.
2972. Will be entitled to contribution among themselves.
2973. When partners liable by estoppel after incorporation.
2974. Liability of members of joint-stock company afterwards incorporated.
2975. Distinction between prerequisite steps and directory provisions.
2976. Failing to file such articles as comply with the statute.
2977. Failing to publish statutory notices of incorporation.
2978. Recording a certificate does not cure defective articles.
2979. Failing to keep corporate books.
2980. Failure to comply with a statute requiring the posting of by-laws.
2981. Increasing capital stock without filing new certificate, etc.
2982. Individual liability of stockholders who have not paid their subscriptions.
2983. Statutory liability until capital paid and certificate thereof filed.
2984. This liability, how measured: illustrations of it.
2985. Further of this liability.
2986. Retroactive effect of such statutes.
2987. Their extraterritorial effect.
2988. What if there is no such statute.
2989. Liability of corporators before stock is distributed.
2990. Corporation and stockholders estopped to set up irregularity of corporate organization.
2991. Conclusiveness of the certificate of incorporation.
2992. Whether creditor estopped by contracting with corporation as such.
2993. *Prima facie* evidence and burden of proof.

§ **2968. Preliminary.** — We have considered in a former chapter the subject of irregular and *de facto* corporations, though not specially with reference to the subject of the liability of stockholders.[1] But we have there stated the principle that where coadventurers contract debts as an aggregate

[1] *Ante*, § 495, *et seq.*

body, without previously effecting a valid corporate organization, they are liable therefor as partners.[1] We have also endeavored in that chapter to point out those acts which are regarded as conditions precedent to a valid corporate organization, and what irregularities will be cured on the principle which validates the acts of *de facto* corporations in collateral proceedings. Finally, we have considered in that and in a subsequent chapter,[2] the circumstances under which a stockholder can question the validity of the existence of the corporation, or the regularity of its organization. We have also considered the question of the personal liability of *promoters*.[3] We shall now consider these questions with special reference to the liability of stockholders to creditors of the corporation.

§ **2969. Until Legal Organization Coadventurers Liable as Partners.** — It is a general principle that until a corporation is legally organized, the coadventurers will be liable as partners for all debts contracted on behalf of the aggregate body, with their consent, either express or implied.[4] Moreover, where the corporation assumes to be regularly organized, and undertakes to go into existence as a corporation, there is a class of cases which hold that *if it is not legally formed*, the stockholders will be liable for its debts as partners.[5] Stated in another way, if a body of associates intend to become incorporated, but engage in business and incur liabilities without taking the necessary steps to perfect their organization as a corporation, or before they have so perfected it, they will be liable therefor as partners.[6] The reason is that they profess that there is a corporation and a corporate fund answerable for such debts, and as there is no such corporation and no such fund, they become personally liable on the principle of *breach of warranty of agency*. These decisions raise the perplexing question to what extent and under what cir-

[1] *Ante*, § 506.

[2] *Ante*, §§ 528, 1877, *et seq.*

[3] Compare, also, *ante*, § 215, *et seq.*

[4] McFall *v.* McKeesport & C. Ice Co., 123 Pa. St. 253, 259; *s. c.* 23 Week. Not. Cas. 146; 16 Atl. Rep. 478.

[5] Kaiser *v.* Lawrence Sav. Bank, 56 Iowa, 104; *s. c.* 41 Am. Rep. 85 (denying Humphrey *v.* Mooney, 1 Colo. Law Rep. 193); Fuller *v.* Rowe, 57 N. Y. 23.

[6] Martin *v.* Fewell, 79 Mo. 401.

cumstances a *de facto* organization, not challenged by the State, will protect the stockholders from the general liability of partners, and the further question what dealings by a creditor with the body as a corporation will be such a *recognition* of its corporate existence as will *estop* him from changing position and attempting to proceed against it as a partnership.[1]

§ 2970. What Evidence Necessary to Charge a Person as Such a Partner. — We have already had occasion to consider what evidence will charge a member of an *abortive corporation* with liability for debts incurred on its behalf.[2] A man cannot ordinarily be made the debtor of another without his consent, express or implied; therefore, while parties assuming to act in a corporate capacity, without a legal organization as a corporate body, are liable *as partners* to those with whom they contract, yet, to charge any one of them as such, it must be shown that he was so acting at the time the contract sued upon was made, or that upon some consideration he agreed to become liable with the others.[3] This is quite clear; since, to charge a person as a partner in an ordinary case, it is necessary to show that he was a member of the firm when the debt was contracted.[4]

§ 2971. Theories on Which Members have been Held Liable. — One theory on which members have been held liable sustains an analogy to the principle on which the English courts proceed in dealing with the liability of promoters,[5] and is not different from the principle upon which an *undisclosed principal* is often charged with liability for the contract of his agent. That theory makes it a *question of fact* in each particular case whether the agent, assuming to make the contract in the artificial name, had authority to bind the members of the body personally. Thus, in an action upon a promissory note made by the "Redwood Iron Manufacturing

[1] *Ante*, § 518, *et seq.*

[2] *Ante*, § 436.

[3] Fuller *v.* Rowe, 57 N. Y. 23. While the principle declared in this case is clear, it is difficult to justify the application which the court made of it to the facts.

[4] McGuire *v.* O'Halloran, Hill & D. (N. Y.) 85.

[5] *Ante*, § 425.

Company, by S. C. Sardham, Agent," it was proved that there had been a corporation by that name; that it had become extinct by the expiration of the time limited for its existence by its charter; that at the time of its dissolution it was the owner of a certain plant; and that, prior to the making of the note, all of its stockholders, except one, made and signed the following agreement: "We, the undersigned, stockholders of the former Redwood Iron Manufacturing Company, hereby agree to unite in getting up a stock for another full-blast, or as near so as possible, and run the furnace, and make iron; and we hereby constitute and authorize S. C. Sardam, as agent or superintendent, to manage or carry on said furnace, and getting up stock for said blast, to sell iron, and do everything pertaining to said business; and we individually agree at all times to furnish money when called on by said Sardam for the purpose of defraying the expenses for carrying on said business; that we are to pay *pro rata*, meaning in proportion to the amount of stock held and owned in said iron manufacturing company by each of us." It was held that this made them partners, especially as to third persons, and that this agreement established the liability of those who signed it to pay the note.[1] So, an action was maintained, upon the following promissory note, against a number of gentlemen who had not signed the same, but who were members of a Masonic lodge, which had authorized the execution of the same by their officers, in renewal of the note which had been given in form as the note of the lodge, the lodge not being regularly incorporated:

"$4,000. "ST. LOUIS, October 3, 1870.

"Twelve months after date, I promise to pay to the order of John W. Luke, Treasurer, four thousand dollars, without defalcation or discount, for value received, negotiable and payable at the Third National Bank of St. Louis, with ten per cent interest from date, payable semi-annually.

[SIGNED] "CHARLIE THAW, W. M.,
"Polar Star Lodge, No. 79."

[Indorsed] "JOHN W. LUKE, Treasurer."[2]

[1] National Union Bank *v.* Landon, 45 N. Y. 410.

[2] Ferris *v.* Thaw, 72 Mo. 446; affirming *s. c.* 5 Mo. App. 279.

The evidence showed that the act of the officers of the lodge in making the note had been ratified by all of the defendants against whom the action was brought. This, in the opinion of the court, made them liable upon the theory of undisclosed principals. Sherwood, C. J., said: "Taking it thus that the act of Thaw, in respect of the new note, was ratified by defendants, they are to be treated as original promisors; as undisclosed principals; as much bound by Thaw's act as if their own fingers had guided the pen, and their own signatures appeared on the paper. For if the agent possesses the requisite authority to make an unsealed instrument, and makes it in his own name, whether he discloses his agency or not, or his principal or not, either agent or principal may sue or be sued on the contract, unless there be a clear manifestation that both parties intended that the agent is to be exclusively liable, and the principal is not to be resorted to in any event; and parol evidence is admissible to establish such intention, as this evidence does not contradict that which is written, but only serves to show that others than those mentioned on the face of the paper are bound also, since the act of the agent is that of his principal; the liability of the latter depending on the act done, and not merely on the form in which such act finds expression."[1] We may therefore conclude that if one member of such an association, acting for the others, and by their authority, incurs a liability in his own name, not evidenced by a writing under *seal*, whether he discloses his agency or not, the obligee may not only hold him, but may go behind him, and hold the other members of the association, on the principle that enables one who contracts with an agent to hold the undisclosed principal.[2] The circumstance that the associates agreed to be bound in form by the name of one of their members does not vacate their liability. "If Smith choose to call himself Snooks, and to make a contract by the name of Snooks, he binds himself as effectually as if he had signed the name of Smith."[3]

[1] Ferris *v.* Thaw, 72 Mo. 450; affirming *s. c.* 5 Mo. App. 279.

[2] *Ibid.*

[3] *Per* Bakewell, J., in Ferris *v.* Thaw, 5 Mo. App. 279, 288; citing Snooks' Petition, 2 Hilt. (N. Y.) 575.

§ 2972. And will be Entitled to Contribution Among Themselves. — In such a case, those of the associates who pay the debts incurred by the managers on behalf of the association, will be entitled to maintain an action or actions against the others for *contribution*, and each of the others will be bound to contribute in proportion to the stock subscribed by him. Nor will the fact that the subscriber has paid up his subscription in full, or has paid the double liability to which stockholders in corporations may be subject under the laws, exempt him from liability for further contribution; but he will be entitled, upon an accounting, to credit for such payments.[1]

§ 2973. When Partners Liable by Estoppel after Incorporation. — Where partners have dealt as such with a third person who has sold goods to them, and, after becoming incorporated, they continue to deal with him as before, having their bills made in the same way, without apprising him of their altered condition, they will continue to be liable to him as partners, under the principle of estoppel, unless he have actual knowledge, derived from some other source, of the fact of their having become incorporated.[2]

§ 2974. Liability of Members of Joint-stock Company afterwards Incorporated. — If an unincorporated joint-stock company contracts liabilities, and afterwards becomes incorporated, and assigns its property to the corporation, the members of the unincorporated association remain primarily and jointly and severally liable for the debts so contracted. The responsibility of the corporation for debts so contracted by the voluntary association does not become substituted, without the consent of the creditors, so as to exempt the members

[1] Richardson *v.* Pitts, 71 Mo. 128. These views are sustained by the following decisions: Hill *v.* Beach, 12 N. J. Eq. 31; Hodgson *v.* Baldwin, 65 Ill. 532; Flagg *v.* Stowe, 85 Ill. 164; Abbott *v.* Omaha Smelting Co., 4 Neb. 416. As to *contribution among stockholders*, see *post*, § 3816, *et seq.*

[2] Martin *v.* Fewell, 79 Mo. 401, 412; Goddard *v.* Pratt, 16 Pick. (Mass.) 412; Whitwill *v.* Warner, 20 Vt. 425.

from individual liability.[1] But the corporation which thus steps into the shoes of the joint-stock company, and accepts an assignment of its property, becomes also primarily liable for the existing indebtedness of the company.[2] The creditors thus retain the same security which they had before, namely, the property of the joint-stock company, now that of the corporation, and the individual liability of the members of the joint-stock company, who now become corporators.[3] But existing creditors of the joint-stock company may, by acts which indicate a clear understanding that the credit of the corporation is substituted for that of the partners, discharge the latter from personal liability for the partnership debts, as by continuing with the corporation their previous course of dealing with the partnership, and transferring on their books their account against the partnership to their account against the corporation.[4] Where, in such a case, the members of the joint-stock company had paid in their several subscriptions, amounting to a joint stock of $37,000, and afterwards procured themselves to be incorporated by the Legislature, the act of incorporation containing the words "with a present capital of $60,000, and with the privilege of increasing the same to $100,000," they were held liable to contribute enough more to make up the sum of $60,000, if necessary to pay the debts of the concern; since "persons dealing with the corporation, and desiring to know what their means were, might well suppose that the whole sum had been paid in, and was in the hands of their treasurer," and "the fact that only $37,000 had been subscribed or paid in was calculated to surprise and operate as a fraud on creditors, for which the corporation is responsible."[5]

§ 2975. Distinction between Prerequisite Steps and Directory Provisions. — Referring to a distinction already twice

[1] Broyles *v.* McCoy, 5 Sneed (Tenn.), 602; Goddard *v.* Pratt, 16 Pick. (Mass.) 412.

[2] Haslett *v.* Wotherspoon, 1 Strobh. Eq. 209, 228, 255.

[3] Haslett *v.* Wotherspoon, 1 Strobh. Eq. 209, 228, 255.

[4] Whitwell *v.* Warner, 20 Vt. 425.

[5] Haslett *v.* Wotherspoon, 1 Strobh. Eq. 209, 229.

alluded to,[1] it is conceded that "there may indeed be certain irregularities or omissions to comply with provisions merely directory, which would be sufficient to sustain an action brought to declare a forfeiture, but insufficient to sustain a collateral action brought to enforce an individual liability of a member." But it is said that "where the attempt at incorporation is under a general law, and there is a non-compliance with the law in a material respect, there is, we think, such want of incorporation that exemption from individual liability is not secured."[2] Reasoning upon this question it has been also said: "There is a manifest difference where a corporation is created by a special charter, and there have been acts of *user*, and where individuals seek to form themselves into a corporation under the provisions of a general law. In the latter case it is only in pursuance of the provisions of the statute for such purpose that corporate existence can be acquired. And there would seem to be a distinction between the case where, in a suit between a corporation and a stockholder or other individual, the plea of *nul tiel corporation* is set up to defeat a liability which the one may have contracted with the other, and the case of a suit against individuals who claim exemption from individual liability on the ground of their having become a corporation formed under the provision of a general statute. In the latter case a stricter measure of compliance with statutory requirements will be required than in the former."[3] As already seen,[4] the quality of a condition precedent has been ascribed to a statutory requirement that the *articles of incorporation shall be filed* in a certain public office,[5] or with the Secretary of State;[6] or, in case of a banking

[1] *Ante*, §§ 226, 508.

[2] Kaiser *v.* Lawrence Sav. Bank, 56 Iowa, 104; *s. c.* 41 Am. Rep. 85.

[3] Bigelow *v.* Gregory, 73 Ill. 197, 201; Kaiser *v.* Lawrence Sav. Bank, 56 Iowa, 104, 110; *s. c.* 41 Am. Rep. 85. See, further, Abbott *v.* Omaha Smelting &c. Co., 4 Neb. 416; Harris *v.* McGregor, 29 Cal. 124; Mokelumne Hill &c. Co. *v.* Woodbury, 14 Cal. 424; *s. c.* 73 Am. Dec. 658; Granby Mining Co. *v.* Richards, 95 Mo. 106, 111. But compare Buffalo &c. R. Co. *v.* Cary, 26 N. Y. 75, 77; Krutz *v.* Paola Town Co., 20 Kan. 403; Eaton *v.* Aspinwall, 19 N. Y. 119, 121.

[4] *Ante*, § 239.

[5] Bigelow *v.* Gregory, 73 Ill. 197.

[6] *Ante*, § 240; Hurt *v.* Salisbury, 55 Mo. 310. See, also, Abbott *v.* Omaha Smelting Co., 4 Neb. 416; Harris *v.* McGregor, 29 Cal. 124.

corporation, that certain prescribed *securities* shall be *deposited* in a public depository;[1] in either which case, if debts are contracted before the performance of the condition, the stockholders are liable therefor as partners. But where the frame of language employed by the statute does not necessarily imply that the filing of the articles shall be a condition precedent to the assumption of corporate powers, or the execution of corporate contracts, the failure to comply with it will be regarded as the neglect to comply with a directory statute, such as cannot be taken advantage of *collaterally* to defeat the existence of the corporation, and make its stockholders liable as partners.[2]

§ **2976. Failing to File such Articles as Comply with the Statute.** — Where the governing statute prescribes what the articles of incorporation shall contain, the failure to file such articles will be the same as filing no articles at all. This will be a failure to comply with substantial, and not merely with directory, requirements of the statute, and the coadventurers will not become incorporate and secure the immunities of stockholders. Thus, a statute of Iowa prescribes that "such articles of incorporation must fix the highest amount of indebtedness or liability to which the corporation is at any one time to be subject, which must in no case, except in that of risks of insurance companies, exceed two-thirds of its capital stock."[3] Another section provides that "a failure to comply substantially with the foregoing requirements, in relation to organization and publicity, renders the individual property of the stockholders liable for the incorporate debts."[4] Following these statutes, it is held that where the articles of incorporation do not fix the highest amount of indebtedness or liability which the corporation may incur, the stockholders remain individually liable for the corporate debts, although the credit may have been given to the corporation as such.[5] But

[1] Medill *v.* Collier, 16 Ohio St. 599.

[2] Granby Mining Co. *v.* Richards, 95 Mo. 106.

[3] Iowa code of 1873, § 1061; McClain Ann. Code, § 1611.

[4] Iowa Code of 1873, § 1068; McClain Ann. Code, § 1618.

[5] Huer *v.* Carmichael, 82 Iowa, 288; 9 Rail. & Corp. L. J. 274; *s. c.* 47 N. W. Rep. 1034.

where the articles which were filed recited that "the total indebtedness of this corporation shall not at any one time exceed $300, except by a majority vote of the stockholders present at a called or annual meeting," this was held a sufficient compliance with the statute.[1] And so, where the articles recited that "the greatest amount of indebtedness to which the corporation may at any one time subject itself shall not exceed three-fifths of the stock actually subscribed for," and the company commenced business before all the stock authorized to be raised by its articles had been subscribed for, it was held that its stockholders were not personally liable for its debts.[2] So, where a statute of Kansas required that "the charter of an intended corporation must be subscribed by five or more persons, three of whom must be citizens of this State, and must be acknowledged by them before an officer duly authorized to take acknowledgment of deeds,"[3] and the paper purporting to be the articles of association, which is understood to be the paper designated by the word "charter" in the statute, was so informally drawn that the court could not say that it was subscribed by any one, and was not acknowledged by a sufficient number of subscribers to comply with the statute, it was held by the Supreme Court of Iowa that the company had not become incorporate, and that its members were liable as partners.[4] The paper consisted of eight articles. The first six articles purported to be subscribed by twenty-three persons, but the seventh and eighth were not subscribed, and the seventh was, under the statute, material. They were all defective for want of being acknowledged by a sufficient number of persons to comply with the statute. But where there was no provision in the governing statute by which individual liability should attach to the members, by reason of any omission to organize the corporation in the manner prescribed by the act, it was held that an omission from the certificate of a mining corporation of the statutory

[1] Thornton *v.* Balcom (Iowa), 52 N. W. Rep. 190.

[2] Sweney *v.* Talcott, 52 N. W. Rep. (Iowa) 106.

[3] Gen. Stat. Kan., ch. 23, § 8.

[4] Kaiser *v.* Lawrence Sav. Bank, 56 Iowa, 104; *s. c.* 41 Am. Rep. 85.

requirement as to the assessability of its stock, could not, in the absence of fraud, be regarded as essential to the corporate existence in an action by one against the individual members upon a contract with the company.[1]

§ 2977. Failing to Publish Statutory Notices of Incorporation. — So, there are statutes requiring the publication by the corporators of certain prescribed notices before an immunity from personal liability for the corporate debts is allowed to attach to them. Such is a statute of Iowa, which enacts that "a notice must also be published for four weeks in succession, in some newspaper as convenient as practicable to the principal place of business,"[2] and prescribes in detail what such notice must contain.[3] Another section of the statute enacts that "a failure to comply substantially with the foregoing requisitions in relation to organization and publicity renders the individual property of the stockholders liable for the corporate debts. But this section shall not be deemed applicable to railway corporations and corporators, and stockholders in railway companies shall be liable only for the amount held by them in said companies."[4] It is observed that *railway companies* are excluded from the operation of the last section, and, therefore, in considering the decisions construing it, those companies must be left out of view.[5] Another section of the same statute recites that "the corporation may commence business as soon as the articles of incorporation are filed in the office of the recorder of deeds, and their doings shall be valid if the publication in a newspaper is made, and

[1] Humphreys *v.* Mooney, 5 Colo. 282. See *ante*, § 228, *et seq.*

[2] Iowa Code of 1873, § 1062; McClain Ann. Code, § 1612.

[3] Iowa Code of 1873, § 1063; McClain Ann. Code, § 1613.

[4] Iowa Code of 1873, § 1068; McClain Ann. Code, § 1618. It is perceived that the statute is peculiar, in that it seems to recognize the existence of the corporation in speaking of "corporate debts," giving an example of a corporation with an unlimited liability on the part of its members.

[5] First Nat. Bank *v.* Davies, 43 Iowa, 424. In this case two of the three judges held that a *railway construction company* was a railway company within the meaning of the statute, the other two dissenting. The decision was an aberration. A corporation organized merely to *build* railroads is a mere *manufacturing* corporation.

articles recorded in the office of Secretary of State within three months from such filing in the recorder's office."[1] The Supreme Court of Iowa have fallen into a confusing and contradictory interpretation of these sections. They first held that a failure to file the articles of incorporation in the office of the Secretary of State did not prevent the character of a corporation from attaching to the organization, or render the stockholders liable to creditors.[2] They next held that a failure to publish such a notice as is required by the statute,[3] and, for stronger reasons, a failure to publish any notice whatever,[4] prevented an immunity from liability for the debts of the corporation from attaching to the stockholders. Where the *articles of incorporation* are not so framed as to contain all the statements which the statute requires such published notice to contain, the publication of the articles in lieu of such notice will not be such a compliance with the statute as will release the stockholders from the liability of partners. Thus, where such articles failed to fix the limit of indebtedness which the corporation might incur, as required by another section of the statute, elsewhere referred to,[5] a publication of the articles in lieu of the statutory notice did not exempt the stockholders from individual liability;[6] and the same holding was made where the articles, published in lieu of the statutory notice, failed to state when the corporate life was to begin and terminate.[7] But it is conceded that where articles of association do contain all that is required to be stated by the statute requiring such publication, then a publication of the articles would be regarded as a substantial compliance with the statute.[8] And where a paper was published, purporting to be the

[1] Iowa Code of 1873, § 1064; McClain Ann. Code, § 1614.

[2] First Nat. Bank *v.* Davies, 43 Iowa, 424; followed in Eisfeld *v.* Kenworth, 50 Iowa, 389, and in Stokes *v.* Findlay, 4 McCrary (U. S.), 205. The case in 43 Iowa did not really decide anything more than that the corporation in question was a *railway company*, and hence excepted by the statute.

[3] Clegg *v.* Hamilton &c. Grange Co., 61 Iowa, 121.

[4] Marshall *v.* Harris, 55 Iowa, 182.

[5] *Post*, § 2978.

[6] Heuer *v.* Carmichael, 82 Iowa, 288; *s. c.* 9 Rail. & Corp. L. J. 274; 47 N. W. Rep. 1034.

[7] Clegg *v.* Hamilton &c. Grange Co., 61 Iowa, 121.

[8] Heuer *v.* Carmichael, *supra*.

articles of association of a corporation, which paper was really a synopsis or abstract of such articles, but which contained all the requirements of the statute prescribing the publication of the notice, it was held sufficient to satisfy the statute.[1] In view of the section of the statute above quoted, reciting that "the corporation may commence business as soon as the articles of incorporation are filed," etc., it has been held that the fact that the requirement as to publication was *not completed* within the ninety days named in the statute, did not make the members personally liable for the debts of the corporation, where the publication had been *commenced* before the expiration of the ninety days, especially where the evidence showed that, at the time when the creditor made his contract with the corporation, he knew that he was dealing with a corporation. The court proceeded upon the view that the policy of the law exacts a *substantial*, but not a *literal*, compliance with the statute.[2]

§ 2978. Recording a Certificate does not Cure Defective Articles.—It has been held by the Supreme Court of Iowa, construing a statute of Kansas relating to the organization of savings banks, that the filing in the office of the registry of deeds, by the president and secretary of such a banking corporation, of the certificate prescribed by the statute, does not cure the filing of a defective "charter," understood to mean articles of incorporation, in the office of the Secretary of State. The statute requiring the recording of this certificate was as follows: "Before any such corporation [a savings bank] shall commence business, a majority of the shares thereof shall be subscribed for, and the entrance fee thereon shall be paid in, and the president and secretary thereof, under their hands and seals, shall make a certificate, which shall specify, first, the corporate name of such association; second, the name of the city or town in which such corporation is to be located; third, the amount of capital stock and the number of shares

[1] Thornton *v.* Balcom (Iowa), 52 N. W. Rep. 190.

[2] Thornton *v.* Balcom (Iowa), 52 N. W. Rep. 190.

into which the same shall be divided; fourth, the names and places of residence of the stockholders and the number of shares held by each; fifth, the time when such incorporation was organized; which certificate shall be acknowledged before a notary public, and recorded in the registry of deeds for the county in which such corporation is to be located." The Iowa court drew the conclusion above stated from that part of the statute prescribing that the certificate should be filed "by the president and secretary," indicating a prior corporate organization and election of officers. The court also dwelt on that clause of the statute which requires the certificate to state "the time when such incorporation *was organized.*"[1] The propriety of the conclusion of the court seems obvious. The filing of articles of incorporation with the Secretary of State, such as the statute requires, seems to be the substantial condition precedent to a corporate organization. This, in the natural order of time, will be followed by an organization *in fact* under such articles, which will consist of a meeting and an election of officers. Then the officers so elected give publicity to the antecedent fact of the organization, by filing for record the certificate prescribed by the above statute. So, where the governing statute required the certificate of incorporation to state, among other things, the names of the city or town and county in which the principal business of the corporation was to be located, and the certificate in question merely recited that "the operations of the company are to be carried on in the county of Calaveras, State of California," it was held that this was not a compliance with the statute, that there was no incorporation, and that the members were liable as natural persons.[2]

[1] Kaiser *v.* Lawrence Sav. Bank, 56 Iowa, 104; *s. c.* 41 Am. Rep. 85.

[2] Harris *v.* McGregor, 29 Cal. 124. It has been held at *nisi prius* in Pennsylvania that the individual members of a co-operative association organized under the Pennsylvania act of June 7, 1887, were not personally liable for its debts, where its articles contained the term of its corporate existence as required by the statute, but, through a mistake occurring in the office of the Secretary of State, such term was omitted in the copy sent to the county recorder. Bendall *v.* Jackson, 11 Pa. Co. Ct. 183. Compare *ante*, § 239.

§ 2979. Failure to Keep Corporate Books. — A statute of Iowa enacts as follows: "The books of the company must be so kept as to show intelligibly the original stockholders, their respective interests, the amount paid on their shares, and all transfers thereof; and such books, or a correct copy thereof, so far as the items mentioned in this section are concerned, shall be subject to the inspection of any person desiring the same."[1] A failure to keep the books of the company in the manner prescribed by this statute does not render the stockholders liable for its debts.[2]

§ 2980. Failure to Comply with a Statute Requiring the Posting of By-laws. — A statute of Iowa enacts that "a copy of the by-laws of the corporation, with the name of all its officers appended thereto, must be posted in the principal places of business, and be subject to public inspection."[3] A failure to comply with this requirement does not render the stockholders liable for the debts of the corporation, for the reason that this is not one of the "foregoing requisitions" named in section 1068 of the Iowa code, already considered, but is a directory statute merely.[4]

§ 2981. Increasing Capital Stock without Filing New Certificate, etc. — The effect of increasing the capital stock of a corporation upon the statutory individual liability of its shareholders has been considered in a former chapter with some attention.[5] It has been held, in substance, that where a corporation has been organized under a *special charter* granted by the Legislature, and proceeds to increase its capital stock under the provisions of a *general law*, this is tantamount to a *reincorporation* under the general law; so that if there is a fail-

[1] Iowa Code of 1873, § 1078; McClain Ann. Code, § 1628. If the *books* are *falsely kept*, another section of the statute makes it a misdemeanor on the part of those concerned therein, etc. Iowa Code of 1873, § 1075; McClain Ann. Code, § 1625.

[2] Langan *v.* Iowa &c. Construction Co., 49 Iowa, 317, 323.

[3] Iowa Code of 1873, § 1076; McClain Ann. Code, § 1626.

[4] McKellar *v.* Stout, 14 Iowa, 359; Langan *v.* Iowa &c. Construction Co., 49 Iowa, 317, 323.

[5] *Ante*, § 2087, *et seq.*

ure to pay in the full amount of the increased capital, and to file a certificate thereof as required by the general law, the subscribers to the increase of stock will become individually liable for the subsequent debts of the company, to the full extent of the amount subscribed by them respectively.[1] This, in Illinois, is a superadded individual liability. A stockholder is not relieved from it by the payment of the sum subscribed by him; otherwise the statute would be meaningless, for that is his contractual liability. The meaning is that, until the full amount of the subscribed capital is paid in, and a certificate of the fact made and recorded, each stockholder is liable to be sued for the debts of the company to the amount of his stock, although he may have paid his subscription in full.[2] A statute of Rhode Island[3] provides that the members of every incorporated manufacturing company shall be jointly and severally liable for all the debts of the company "until the whole amount of the capital stock fixed by the charter, or by vote, shall have been paid in, and a certificate thereof made and recorded, etc. It has been held that, the original capital stock of a company having been paid in and the certificate filed, as provided by that section, the fact that new stock was subsequently issued, as to which the required certificate was not filed, did not *revive* the individual liability of the holders of the original stock, who had not accepted the new stock.[4] In the same case the court made another holding, which is more obscure, to the effect that in order to subject any of the stockholders to a liability under the statute for failure to file a certificate for an increase of the capital stock, such increase must be made by a valid corporate act.[5] If this is the law, all that the corporate manipulators will have to do in order to increase the capital stock of the corporation, without complying with the

[1] Tibballs *v.* Libby, 87 Ill. 142. If we were to adopt the language of the court, we should say that the holding was that an increase of capital stock under the Illinois insurance law of 1869 is an "incorporation" under that law. The case reaffirms, as to the liability of a stockholder under the law of 1869, Butler *v.* Walker, 80 Ill. 345.

[2] Butler *v.* Walker, *supra.*

[3] Rev. Stat. R. I., ch. 128, § 1.

[4] Sayles *v.* Brown, 40 Fed. Rep. 8.

[5] *Ibid.*, 14.

statute or increasing individual liability, will be to see that the increase is *not made* by a valid corporate act. The Court of Appeals of New York hold that the general manufacturing act of that State, making the individual stockholders of a company liable for a failure of the company to file a certificate showing that its capital stock has been paid up in full, being in derogation of the common law, is to be strictly construed; and hence, that where it appears that such certificate of the *original issue* of the stock has been filed, and that there has been a subsequent issue of *increased stock*, no liability for want of a certificate with respect of such increase can attach to a member of the company until it is proved that he is a holder of part of the increased stock.[1] But this is a vicious interpretation. Such statutes are not penal, but are remedial, designed to *withhold* from the coadventurers corporate immunities, and to leave them, in common with other people, liable to pay their debts until, by complying with the statute, they substitute for their personal security the corporate fund which they profess to have. Such a statute of Maryland has been held equally applicable to an *increase* of the capital stock by the corporation, under a statute authorizing such increase, as to the original fixing of it in the charter; so that, until all the stock, as increased, is paid in, the members are severally liable for the corporate debts.[2]

§ 2982. Individual Liability of Stockholders Who have not Paid Their Subscriptions. — Where, according to the language or proper interpretation of the governing statute, the existence of the corporation dates from the filing of the articles, the stockholders and managers cannot be held liable as partners for debts contracted by the corporation after the articles have been filed, although previous to the payment of their subscriptions,[3] unless the statute in terms makes them so liable.[4]

[1] Griffeth *v.* Green, 129 N. Y. 517; *s. c.* 29 N. E. Rep. 838; affirming *s. c.* 13 N. Y. Supp. 470.

[2] Booth *v.* Campbell, 37 Md. 522.

[3] National Bank *v.* Texas Invest. Co., 74 Tex. 421; *s. c.* 12 S.W. Rep. 101; 6 Rail. & Corp. L. J. 373.

[4] A statute exists in Massachusetts (Mass. Stat. 1870, ch. 224, § 1; 1875, ch. 177, § 1), by the terms and

§ 2983. Statutory Liability Until Capital Paid and Certificate thereof Filed. — Another statutory provision, existing in several of the States, is to the effect that until the capital stock of a corporation shall have been paid in, and a certificate thereof filed in some office of public registration, the stockholders shall be individually liable for its debts.[1] Under some of these statutes the liability attaches to the stockholders, although, for other purposes, the corporation may have acquired a valid organization,[2] and although the contract may not be *ultra vires*, but may be enforceable by the corporation on its part.[3] As in the case of some other like statutes,[4] the effect of the omission is not to invalidate contracts made by the corporation until the condition is complied with, but is to leave the members liable to answer for them.[5] On the other hand, such a statute [6] has been held to mean that the several stockholders of a corporation are individually liable until the whole amount of its capital stock shall have been paid in, for any debts of the corporation contracted before that time, and that the subsequent paying in of all the stock terminates the liability. If, therefore, the whole capital stock of a company was *paid in before the trial* of a suit brought by a creditor against a stockholder under this statute, the antecedent liability of the defendant having thus terminated, the plaintiff could not proceed to judgment.[7] And where the statute [8] provides that the shareholders shall be liable *until* the whole amount of the capital stock shall be paid in, and further pro-

construction of which stockholders who have not paid in full the par value of their shares are personally liable for the debts of the corporation, although the certificate required by law, that the capital stock has been paid in, has been filed. First Nat. Bank *v.* Hingham Man. Co., 127 Mass. 563. But this is not understood as making them liable for all the debts as partners; for section 43 provides that no stockholder shall be liable to pay a larger sum than the amount held by him, at its par value. *Ibid.*

[1] Hawes *v.* Anglo-Saxon Petroleum Co., 111 Mass. 200; First Nat. Bank *v.* Almy, 117 Mass. 476.

[2] Baker *v.* Backus, 32 Ill. 79.

[3] Chase's Patent Elevator Co. *v.* Boston Tow Boat Co., 152 Mass. 428; *s. c.* 28 N. E. Rep. 300.

[4] Notably those of Iowa, elsewhere considered, *ante*, § 2978, *et seq.*

[5] Chase's Patent Elevator Co. *v.* Boston Tow Boat Co., *supra.*

[6] Supp. to Code Md. 1868, art. 26.

[7] Booth *v.* Campbell, 37 Md. 522.

[8] N. Y. Laws 1848, ch. 40, § 10.

vides that it shall be paid in within two years, the creditor is not bound to wait until the expiration of that time before proceeding against a stockholder.[1] The *payment* of the stock exacted by this statute may be either a payment in *money* or in *property* honestly regarded as a fair equivalent of money; and where payment had been made, not in cash, but in the transfer to a corporation of certain *worthless inventions*, a verdict of a jury against a stockholder was sustained, the evidence being, in the view of the court, "sufficient, if not overwhelming."[2] The statute covers "all debts and contracts made by said company," irrespective of the circumstances under which they were made. No exemption from the liability imposed by the statute is allowed merely because credit may have been imprudently given to the corporation by the creditor, or because he may have given credit upon the supposition that the property of the corporation was sufficient to pay its debts. It is further held that proof that shares of stock of the company have been issued as fully paid, when they have not been fully paid, establishes fraud in law, and it is not necessary to supplement this by proving an actual fraudulent intent. So, also, if it be shown that the shares were issued in exchange for property, with a knowledge on the part of the

[1] King *v.* Duncan, 38 Hun (N. Y.), 461. There is a seemingly untenable decision by a majority of the judges of the New York Court of Appeals to the effect that under a provision of the *insurance law* of that State (N. Y. Act 1849, ch. 308, § 19), making the corporators jointly and severally liable until the whole amount of the "capital *raised*" by the company shall have been paid in and the comptroller's certificate thereof recorded, it is not necessary that the whole amount of the capital of the company be *paid in*, and a certificate thereof filed, to relieve a corporator from liability. Chase *v.* Lord, 77 N. Y. 1; reversing *s. c.* 16 Hun (N. Y.), 369; (Earl, Folger, and Miller, JJ., dissenting.) When it appears that the sum required by sections 5 and 6 of said chapter 308 has been paid in, the comptroller is required to give the certificate without regard to the nominal capital of the company. The company, upon filing certified copies of this certificate and of the charter, as prescribed by section 11, may begin business, and thenceforth the corporators are released from personal liability. (Earl, Folger, and Miller, JJ., dissenting.) *Ibid.* The functions of "corporators" cease with the organization; afterwards they are "stockholders," and not liable as corporators. (Earl, Folger, and Miller, JJ., dissenting.) *Ibid.*

[2] National Tube Works Co. *v.* Gilfillan, 124 N. Y. 302; *s. c.* 26 N. E. Rep. 538.

trustees of the corporation that the value of the property was much less than the par value of the shares, no other fraudulent intent need be shown to authorize a recovery against a stockholder, under the statute, than such as is evidenced by such action.[1]

§ 2984. **This Liability how Measured: Illustrations of It.** — The amount of this liability is measured by the par value of the stock held by each stockholder, and is in no way affected by the amount of capital that may at any time remain unpaid.[2] The statute of Maryland,[3] to which the foregoing reference is made, is silent as to the creditor's remedy. The court hold that he may proceed either at law[4] or in equity.[5] Under the New York statute regulating the formation of ocean steamship companies, a stockholder, even if he had fully paid up his stock, or held by assignment fully paid stock, was held liable for the entire amount he held for all debts contracted while he owned the stock, not only until the stock was fully paid up, but also until the certificate thereof was duly filed.[6] Where a corporation entered upon the enterprise for which it was created upon a less sum of money than they had given out through the act which they had procured the Legislature to pass incorporating them, and afterwards became insolvent, the stockholders were held bound to make up the deficiency for the benefit of creditors; and those who were solvent were held bound to make good the deficiency created by the failure of those who were insolvent. In other words, they were held liable, to all intents and purposes, as partners.[7] But the same court afterwards held that where there is no statutory prohibition against commencing business before the capital is paid in, and no fraud appears on the part of the stockholders or corporation, the solvent stockholders are not bound to make

[1] National Tube Works Co. *v.* Gilfillan, 124 N. Y. 302; *s. c.* 26 N. E. Rep. 538.

[2] Norris *v.* Johnson, 34 Md. 485.

[3] *Ante*, § 2983.

[4] *Ibid.*

[5] Matthews *v.* Albert, 24 Md. 527.

[6] Eaton *v.* Aspinwall, 19 N. Y. 119; *s. c.* 3 Abb. Pr. 417; 6 Duer (N. Y.), 176; 13 How. Pr. (N. Y.) 184.

[7] Haslett *v.* Wotherspoon, 1 Strobh. Eq. (S. C.) 209.

up the deficiencies of insolvent stockholders for the benefit of the creditors of the company.[1]

§ 2985. **Further of this Liability.** — A weak decision was made by a Circuit Court of the United States in a case where it appeared that a bank was organized and commenced business without paid-up capital, without making a sworn statement of its paid-up capital to the State auditor, and without a certificate from the State auditor authorizing the association to commence business; all these things being required by the governing statute.[2] Construing this statute with other provisions of the statutes of the same State, the court held that, notwithstanding these failures, there was an *imperfect organization*, and that it was not the case of no corporation, in which the incorporators would be liable to creditors as partners.[3] The Supreme Court of Georgia have halted at a sort of half-way house, by holding that when the stock of a corporation is not subscribed for up to the *minimum* amount, and none is paid in, if the corporators organize and contract debts beyond the nominal capital, without paying in anything, they thereby *commit a fraud*, rendering themselves liable to creditors to make good the *minimum* capital, together with interest, if necessary to discharge the debts.[4] Such a statute cannot be judicially repealed, but must be complied with, in substance at least. The fact that the capital may have been paid in will not exonerate the stockholders, unless the statutory certificate is made and recorded within the prescribed time;[5] nor will the recording of a certificate which is merely *acknowledged*, but *not sworn to*, as required by the statute, exonerate them.[6] Under a statute enacting that "the trustees and corporators of any company organized under this act shall be severally liable for all debts or responsibilities of such company to the

[1] South Carolina Man. Co. *v.* Bank, 6 Rich. Eq. (S. C.) 227.

[2] Iowa Code, § 1576.

[3] Stokes *v.* Findlay, 4 McCrary (U. S.), 205.

[4] Burns *v.* Beck, 83 Ga. 471; *s. c.* 10 S. E. Rep. 121.

[5] Plass *v.* Housman, 17 N. Y. 671; *s. c.* 2 N. Y. Supp. 235.

[6] Hardman *v.* Sage, 124 N. Y. 25; *s. c.* 35 N. Y. 54; 26 N. E. Rep. 354.

amount by him or them subscribed, until the whole amount of the capital of such company shall have been paid in, and a certificate thereof recorded as herein before provided,"[1] a stockholder is not relieved from this liability by the payment of the sum subscribed by him, — otherwise the statute would be meaningless, because that is the liability which he assumes by virtue of his contract of subscription. The statute imposes a *superadded personal liability* upon each stockholder to the amount of the stock subscribed by him. The meaning is, that until the full subscribed capital is paid in, and a certificate of the fact made and recorded, he stands under a personal liability for the debts of the corporation to the amount of his subscription, although he may have paid it in once.[2]

§ 2986. **Retroactive Effect of such Statutes.** — There is some difficulty in upholding such a statute, in so far as it operates retrospectively upon existing special charters; but this difficulty has been surmounted by the Supreme Court of Illinois, so as to uphold a general statute making directors and stockholders liable for the debts of a company organized under a special charter before its passage, the capital stock not having been wholly paid in.[3]

§ 2987. **Their Extraterritorial Effect.** — Statutes of the kind under consideration, making the stockholders liable for all debts and contracts made by the company before the capital stock has been paid in, and a certificate thereof made and recorded, etc., fall within the class of statutes which are construed as *remedial* and not as *penal*,[4] and are consequently enforced by the courts of other States than those enacting them.[5]

[1] Laws Ill., Act March 11, 1869, § 16.

[2] Butler *v.* Walker, 80 Ill. 345; reaffirmed in Tibballs *v.* Libby, 87 Ill. 412.

[3] Gulliver *v.* Roelle, 100 Ill. 141; Black *v.* Womer, 100 Ill. 328. (Dickey, C. J., and Sheldon, J., dissented.) See *post*, § 3082.

[4] *Post*, §§ 3016, 3017.

[5] Flash *v.* Conn, 16 Fla. 428; *s. c.* 26 Am. Rep. 721. Compare Sayles *v.* Brown, 40 Fed. Rep. 8.

§ 2988. What if there is no such Statute. — But where a corporation is organized under a general statute, and there is no provision in the statute, nor in the articles of incorporation, that all of the potential or authorized stock of the corporation shall be subscribed before it commences business, nor that any definite sum shall be subscribed, the fact that it does commence business after a part only of such authorized or potential stock has been subscribed, does not make or leave its members liable as partners for its debts.[1] It is to be kept in mind that we are not dealing with the question whether the corporation can hold the subscriber and compel him to pay *assessments* upon his subscription before all of the authorized or potential stock has been subscribed. This has been the subject of a discussion in a former chapter.[2] It may be conceded that where a corporation is organized under a general statute, and where either the statute or the articles of incorporation fix the capital which it may raise, and provide that it shall not commence business until the entire amount so fixed has been subscribed, it cannot enforce an assessment upon its subscribers before that event has happened;[3] though here, as in other cases, the stockholder may assent to the corporation so commencing business, and may become estopped by his conduct from resisting an action for an assessment.[4]

§ 2989. Liability of Corporators before Stock is Distributed. — Where an association of persons have complied with the provisions of the law necessary to constitute them a corporation, and have fixed the amount of their capital stock, but have not divided it, and in this situation contract debts, the individual members are jointly and severally liable for such debts.[5] This liability seems to attach independently of any statute; but there was a statute providing that

[1] Thornton *v.* Balcom (Iowa), 52 N. W. Rep. 190; Sweney *v.* Talcott (Iowa), 52 N. W. Rep. 106.

[2] *Ante*, § 1235, *et seq.*

[3] Tama Water Power Co. *v.* Hopkins, 79 Iowa, 653; *s. c.* 44 N. W. Rep. 798.

[4] International &c. Asso. *v.* Walker, 83 Mich. 326; *s. c.*, on second appeal, 88 Mich. 62.

[5] Hawes *v.* Anglo-Saxon Co., 101 Mass. 385; 111 Mass. 200; First Nat. Bank *v.* Almy, 117 Mass. 476.

the members of such corporations should be jointly and severally liable for such debts as might be contracted before the capital was fully paid in and a certificate thereof duly recorded.[1] The theory is that the members of such a corporation, until the issue of certificates of stock, own the stock in common, and under the statute are all "jointly and severally liable for its debts" contracted before the capital was paid in, although it has voted to divide the capital stock into shares, and one member has agreed to take a certain number thereof.[2] But after the shares have been distributed among the members they are not, under the statute of that State,[3] jointly liable for the debts of the corporation, but only *severally*, in proportion to the shares held by them respectively.[4]

§ 2990. Corporation and Stockholders Estopped to Set up Irregularity of Corporate Organization. — It is easy to understand, on principles elsewhere much considered,[5] that, while a compliance with those steps made by the governing statute conditions precedent to the organization of the corporation may be necessary to exonerate the stockholders from liability as partners,— yet if the question is turned around, they will not be allowed to set up the want of such compliance in order to escape such liability,— thereby taking advantage of their own wrong.[6]

§ 2991. Conclusiveness of the Certificate of Incorporation. — What is, under some statutory systems, called the *certificate of incorporation*, is really nothing more than what, under other systems, is called *articles of association*, or *articles of incorporation*, or in still others the "*charter.*" It is merely the constating instrument which the coadventurers sign, as the basis of their organization under the statute, and lodge

[1] Stat. Mass. 1862, ch. 218, § 2; *ante*, § 2983.

[2] Hawes *v.* Anglo-Saxon Co., *supra.*

[3] Mass. Stat. 1870, ch. 224, §§ 39, 43.

[4] Burnap *v.* Haskins Steam Engine Co., 127 Mass. 586.

[5] *Ante*, § 352, *et seq.*

[6] For pertinent illustrations, see McDougald *v.* Bellamy, 18 Ga. 411; McDougald *v.* Lane, 18 Ga. 444; Hammond *v.* Straus, 53 Md. 1. In the last case, however, the statutory requirements were construed as conditions subsequent.

with the Secretary of State, or other designated officer of the State. The Secretary of State, or other State officer with whom this instrument is lodged, retains the original among his archives, and delivers a *certified copy* of it to the coadventurers, who in turn cause it to be recorded (under many statutory systems) in the office of the recorder of deeds of the county wherein the principal office of the corporation is to be established. This practice of giving a certified copy of it back to the coadventurers seems to have led to its being called a "certificate." If this paper does not comply with the statute, there is no incorporation.[1] But where the statute clothes the Secretary of State, or other State officer with whom the instrument of incorporation framed by the coadventurers is required to be lodged, with the duty of examining it, and of passing upon its formality and legal sufficiency, and of issuing to them a paper certifying that they have become incorporated, — then the issuing of this certificate is a *quasi adjudication* by the officer of the State appointed to pass, provisionally at least, upon the question, *that such a corporation has been formed;* and after *such* a certificate is issued, the corporation is held to be a good corporation, so long as the State does not proceed in its judicial courts to oust its members of their franchises.[2] It was with reference to such a certificate of incorporation that a holding was made in the Court of Appeals of Maryland to the effect that if a vendor sells goods on credit to a *de facto* corporation, and charges the corporation with the goods, and the corporation afterwards becomes insolvent, the vendor cannot support an action against the members of the corporation, by proving that, notwithstanding its certificate of incorporation, certain prerequisites of the law authorizing its incorporation had not been complied with.[3] In such a case the validity of the existence of the corporation can only be tested by proceedings on behalf of the State.[4]

[1] *Ante*, § 221.

[2] *Ante*, § 249.

[3] Laflin &c. Powder Co. *v.* Sinsheimer, 46 Md. 315; *s. c.* 24 Am. Rep. 522. See, also, on a similar case, American Salt Co. *v.* Heidenheimer, 80 Tex. 344; *s. c.* 26 Am. St. Rep. 743; 15 S. W. Rep. 1038.

[4] *Ibid.* To the proposition that where a corporation has acquired a

§ 2992. Whether Creditor Estopped by Contracting with Corporation as such. — A more difficult question is whether the creditor of a body assuming to act as a corporation, who enters into a contract with it as such, thereby estops himself from proceeding against its members as partners or original undertakers, in case it turns out that it is no corporation, or that it is a corporation illegally or defectively organized. Upon this question, as suggested when dealing with it in another relation,[1] there is almost every variety and shade of judicial opinion.[2] 1. It is plain, and, so far as the writer knows, nowhere disputed, that where the statute under which the coadventurers attempt or assume to organize themselves into a corporation prescribes that certain things shall be done before they shall become incorporate or before they shall enter upon business, and adds that until those things are done the coadventurers shall be personally liable for the debts contracted in the name of the assumed or attempted corporation, they are so liable. Such is the statute of Iowa, already considered, and such is the liability of the members of defective or abortive corporations therein;[3] though even under that statute, in a case which did not present a radical defect, the principle of estoppel was allowed to have some weight.[4] Such, also, is a statute of Nebraska, the mere mention of which should have disposed of a case in which the subject was discussed at length upon judicial theories.[5] 2. Outside of the question of the existence of such statutes, and chiefly in jurisdictions where they do not exist, there is a class of cases holding to the simple, just, and easily applied doctrine that where a number

formal or *colorable* existence, its right to exist cannot be challenged in a collateral proceeding, so long as the State acquiesces, see also River Nav. Co. *v.* Neal, 3 Hawks (N. C.), 520; Charles River Bridge *v.* Warren Bridge, 7 Pick. (Mass.) 344, 371; Jones *v.* Dana, 24 Barb. (N. Y.) 395, 399; Center &c. Turnpike Road Co. *v.* M'Conaby, 16 Serg. & R. (Pa.) 140, 145; State *v.* Carr, 5 N. H. 367, 371; Selma &c. R. Co. *v.* Tipton, 5 Ala. 787; *s. c.* 39 Am. Dec. 344; Duke *v.* Cahawba Nav. Co., 16 Ala. 372.

[1] *Ante*, § 495.

[2] See, especially, *ante*, § 518, *et seq.*

[3] Heuer *v.* Carmichael, 82 Iowa, 288; *s. c.* 47 N. W. Rep. 1034.

[4] Thornton *v.* Balcom (Iowa), 52 N. W. Rep. 190; *ante*, § 2983.

[5] Abbott *v.* Omaha Smelting &c. Co., 4 Neb. 416, 422.

of coadventurers assume or attempt, under the provisions of a general statute, to organize themselves into a corporation, and fail to take the steps which that statute makes essential to their becoming incorporate, and assume to contract corporate debts without having taken such steps, they are liable for such debts as partners.[1] 3. Totally opposed to these conceptions is the doctrine of some of the courts that, in the case last named, the shareholders in the defectively organized corporation do not become liable as partners, general or special.[2] These cases, in general, proceed upon the theory that the members are not, in such a case, liable as partners: (*a.*) because they have not agreed among themselves to be so liable; (*b.*) because they have not agreed with the other party to the contract to be so liable; (*c.*) because they have not held themselves out to him as partners; and some of them fall back upon the well-known doctrine[3] that a partnership is not necessarily formed by an abortive agreement to form a corporation;[4] and some of them dwell upon the impropriety of the courts making contracts between parties which they have not made between themselves. 4. Finally, there is a class of cases maintaining the doctrine that where the corporation has been *defectively organized*, but nevertheless has a *colorable organization*, and exists and carries on its business as a corporation *de facto*, the State not electing to interfere,— there being no fraud nor any statute making the stockholders individually liable,— one who enters into a contract with it as a corporation *estops* himself from attempting to enforce the contract against its members as partners or original undertakers.[5] The general theory of these cases is, that the

[1] Bigelow *v.* Gregory, 73 Ill. 197; Coleman *v.* Coleman, 78 Ind. 344; Garnett *v.* Richardson, 35 Ark. 144; Abbott *v.* Omaha Smelting &c. Co., 4 Neb. 416.

[2] Fay *v.* Noble, 7 Cush. (Mass.) 188; Trowbridge *v.* Scudder, 11 Cush. (Mass.) 83; First Nat. Bank *v.* Almy, 117 Mass. 476; Stafford Nat. Bank *v.* Palmer, 47 Conn. 443; Central City Sav. Bank *v.* Walker, 66 N. Y. 424; Blanchard *v.* Kaull, 44 Cal. 440, 450.

[3] *Ante*, § 421, *et seq.*

[4] Blanchard *v.* Kaull, 44 Cal. 440, 451.

[5] Snider's Sons Co. *v.* Troy, 91 Ala. 224; *s. c.* 24 Am. St. Rep. 887; 11 L. R. A. 515; 9 Rail. & Corp. L. J. 272; 43 Alb. L. J. 295; 8 South. Rep. 658; Cory *v.* Lee, 93 Ala. 468;

creditor is estopped by his own contract from so proceeding **against the** stockholders, and that he will not be allowed, in the face of his own contract, to impeach the franchises of a *de facto* corporation, so long as the State is contented that it should exist. It is conceded in some of the cases that this principle can have no application in a case where the corporation does not exist *de facto*, but is a *mere pretense or usurpation;* and in reason and justice, it is absolutely essential to the support of this view that there should be a corporation having *a corporate fund* answerable for the debt as fully as though the organization of the corporation had been legally sufficient. The reasons supporting this theory of the non-liability of the members of *de facto* corporations has nowhere been better stated than in an opinion of the Supreme Court of Alabama, by the late Justice Clopton, where the question was carefully considered: "Maintenance of such suit involves judicial nullification of franchises and powers enjoyed and exercised by a *de facto* corporation as a distinct entity recognized by the law, acquiesced in by the State; defeats the corporate character of the contract; changes the relation from that of stockholders to that of partners; substitutes other and new parties to the contract, and effects the imposition of an enlarged liability, which they did not assume, but intended to avoid, so understood by the creditor when he contracted the debt with the corporation as such. The contract is valid and binding on the corporation which the creditor trusted. No injustice is done him, for all his rights and remedies are preserved by the principle that the corporation and the shareholder are estopped from denying its legal existence as against him. It will not answer to say that he is not repudiating, but enforcing, the contract. He repudiates the party — the corporation — with which he made the contract, and seeks its enforcement

s. c. 8 South. Rep. 694; Stout *v.* Zulick, 48 N. J. L. 599; Planters' &c. Bank *v.* Padgett, 69 Ga. 159; Merchants' &c. Bank *v.* Stone, 38 Mich. 779; Gartside Coal *v.* Maxwell, 22 Fed. Rep. 197; Whitney *v.* Wyman, 101 U. S. 392; American Salt Co. *v.* Heidenheimer, 80 Tex. 344; *s. c.* 26 Am. St. Rep. 743; 15 S. W. Rep. 1033. See, also, Fox *v.* McComb, 15 N. Y. Supp. 783; *post*, ch. 184; *ante*, §§ 518, 1877, *et seq.*

against parties who never entered into contractual relations with him."[1] 5. This principle of estoppel cannot be opposed against the creditor by the stockholders, where the pretended corporation is one which *cannot exist at all* under the laws of the State,— as where the formation of corporations to carry on the business of the particular corporation is *prohibited by the statute law*, or by the public policy of the State implied from its statute law.[2]

§ 2993. Prima Facie Evidence and Burden of Proof.— In order to maintain an action in New York, to charge a stockholder of a company individually for the debts of the company, on the ground that the whole amount of capital stock of the company had not been paid in when the debt was contracted, the plaintiff must show on the trial that the capital stock has not been paid in, although this requires him to *prove a negative*.[3] And generally, where it is sought to charge a stockholder on the ground of non-compliance with the provisions of a statute, the burden is on the plaintiff to show the omission,[4]— the reason being that there is no liability at common law; that the law presumes right acting, and not wrong acting, and hence presumes a compliance with the statute until the contrary is shown.[5]

[1] Snider's Sons Co. *v.* Troy, 91 Ala. 224, 233; *s. c.* 24 Am. St. Rep. 887.

[2] *Ante*, §§ 505, 523, 530, 533.

[3] Bruce *v.* Driggs, 25 How. Pr. (N. Y.) 71; Chase *v.* Lord, 77 N. Y. 1; *s. c.* 6 Abb. N. C. (N. Y.) 258.

[4] Taylor *v.* New England &c. Co., 4 Allen (Mass.), 577. For an *instruction to a jury* to this effect, which met with judicial approval, see Abbott *v.* Omaha &c. Co., 4 Neb. 416, 425.

[5] Chase *v.* Lord, *supra*. An execution against a corporation, issued to one county and returned unsatisfied, is a sufficient compliance with the New York statute (N. Y. Laws 1848, ch. 40, § 24) to charge a stockholder, although the corporation does business in two counties; and evidence that the certificate required by statute to be filed by the corporation has not been filed in one of the counties is *prima facie* evidence that no certificate has been filed. Maher *v.* Carman, 38 N. Y. 25.

CHAPTER XLVI.

CONSTITUTIONAL PROVISIONS CREATING AND ABOLISHING INDIVIDUAL LIABILITY.

SECTION
2998. Constitutional guaranties securing creditors of corporations.
2999. Constitutional provisions restricting the liability to unpaid subscriptions.
3000. Constitutional provisions creating a superadded or double liability.
3001. Provision for a proportional individual liability.
3002. Constitutional guaranties securing creditors of banking companies.
3003. Whether these constitutional provisions are self-enforcing.
3004. Further of this subject.
3005. Effect of a constitutional provision creating a double liability.
3006. Missouri Constitution of 1865, and statute thereunder.
3007. Effect of Missouri constitutional amendment abolishing this double liability.
3008. Creditor may waive constitutional or statutory right to proceed against stockholders.
3009. Incorporating ostensibly for another business in order to evade the rule of individual liability.

§ 2998. Constitutional Guaranties Securing Creditors of Corporations. — The constitutions of several of the States contain provisions intended to secure the creditors of corporations by a personal liability of the stockholders; others exempt the stockholders from personal liability; and still others leave the subject for determination by the Legislature, under such expressions as the following: "Dues from corporations shall be secured by such individual liability of the corporators and other means as may be prescribed by law."[1] In some cases there are *directions to the Legislature*, such as the following: "All general laws and special acts passed pursuant to

[1] Cal. Const. of 1849, art. 4, § 32; Cal. State Const. 1879, art. 12, § 2; Ind. Const. of 1851, art. 11, § 14 ("other than banking"); Mont. Const. 1889, art. 15, § 19; N. C. Const., Amend. of 1876, art. 8, § 2; S. C. Const. of 1868, art. 12, § 4.

this section shall make provisions therein for fixing the personal liability of stockholders under proper limitations; and shall prevent and punish fraudulent misrepresentation as to the capital, property, and resources of such corporations; and shall also regulate the public use of all franchises which have heretofore been, or hereafter may be, created or granted, by or under the authority of this State, and shall limit all tolls, imposts, and other charges and demands under such laws."[1]

§ 2999. Constitutional Provisions Restricting the Liability to Unpaid Subscriptions. — Other constitutional provisions, designed to attract incorporated capital into the State, declare a liability to the amount of shares subscribed for or held, and no more, thus: "Dues from private corporations shall be secured by such means as may be prescribed by law, but in no case shall any stockholder be individually liable otherwise than for the unpaid stock owned by him or her."[2]

§ 3000. Constitutional Provisions Creating a Superadded or Double Liability. — Other constitutional provisions create what has been called a "double liability," which is a superadded liability equal to the par value of the shares held, thus: "Dues from corporations shall be secured by individual liability of the stockholders to an additional amount equal to the stock owned by each stockholder, and such other means as shall be provided by law; but such individual liabilities shall not apply to railroad corporations, nor corporations for religious or charitable purposes."[3] "The stockholders of all

[1] S. C. Const. of 1868, art. 12, § 5.

[2] Ala. Const. of 1875, art. 13, § 8; Mo. Const. of 1875, art. 12, § 9; Nev. Const. of 1864, art. 8, § 3; Neb. Const. of 1875, art. 11, § 4 (in special and particular language); Or. Const. of 1857, art. 11, § 3; Wash. Const. of 1889, art. 12, § 4 ("except banking and insurance companies"); W. Va. Const. of 1872, art. 11, § 2. Similar as to single liability are Idaho Const. of 1889, art. 11, § 17; Minn. Const. of 1857, art. 10, § 3.

[3] Kan. Const. 1859, art. 12, § 2. A provision in a Kansas charter that the stockholders shall not be individually liable for the corporate debts is hence *unconstitutional;* but it may be rejected, and does not invalidate the organization. Aultman *v.* Waddle, 40 Kan. 195; *s. c.* 19 Pac. Rep. 730.

corporations and joint-stock associations shall be individually liable for all *labor* performed for such corporation or association."[1]

§ 3001. Provision for a Proportional Individual Liability. The Constitution of *California* contains this provision: "Each stockholder of a corporation or joint-stock association shall be individually and personally liable for such proportion of all its debts and liabilities contracted or incurred during the time he was a stockholder,[2] as the amount of stock or shares owned by him bears to the whole of the subscribed capital stock or shares of the corporation or association.[3] The directors or trustees of corporations and joint-stock associations shall be jointly and severally liable to the creditors and stockholders for all moneys embezzled or misappropriated by the officers of such corporation or joint-stock association, during the term of office of such director or trustee."[4]

§ 3002. Constitutional Guaranties Securing Creditors of Banking Companies. — "Every stockholder in a banking corporation or institution shall be individually responsible and liable to its creditors, over and above the amount of stock by him or her held, to an amount equal to his or her respective shares so held, for all its liabilities accruing while he or she remains such stockholder."[5] "The officers and stockholders of

[1] Mich. Const. of 1850, art. 15, § 7. As to liability for "labor debts," see *post*, § 3141, *et seq.*

[2] The words "during the time he was a stockholder" were not in the corresponding provision of the Constitution of 1850, but were placed there by a judicial interpolation. Larrabee *v.* Baldwin, 35 Cal. 155, 166. Under this provision shares are assessable although *full paid.* Santa Cruz R. Co. *v.* Spreckels, 65 Cal. 193; Green *v.* Abietine Medical Co., 96 Cal. 322, 328.

[3] Section 322 of the Cal. Civ. Code, adopted in 1876, was not abrogated by this provision. Borland *v.* Haven, 37 Fed. Rep. 394.

[4] Cal. State Const. of 1879, art. 12, § 3.

[5] Ill. Const. of 1870, art. 11, § 6. Similar are, Ind. Const. of 1851, art. 11, § 6; Iowa Const. of 1857, art. 8, § 9. The provision in the Iowa Constitution, in the language above quoted, refers only to banks issuing *circulating notes*, and not to banks of discount and deposit merely. Allen *v.* Clayton, 63 Iowa, 11; *s. c.* 50 Am. Rep. 716. A *specially chartered* bank, as well as one organized under the general law of 1838, was within the personal liability

every corporation or association for banking purposes, issuing bank notes or paper credits to circulate as money, shall be individually liable for all debts contracted during the term of their being officers or stockholders of such corporation or association, equally and ratably to the extent of their respective shares of stock in any such corporation or association."[1] "Every stockholder in a banking corporation or institution shall be individually responsible and liable to its creditors over and above the amount of stock by him held, to an amount equal to its respective stock or shares so held, for all its liabilities accruing while he remains such stockholder; and all banking corporations shall publish quarterly statements, under oath, of their assets and liabilities."[2] "No corporation, association, or individual shall issue or put in circulation as money anything but the lawful money of the United States. Each stockholder of any banking or insurance corporation or joint-stock association shall be individually and personally liable equally, and ratably, and not one for another, for all contracts, debts, and engagements of such corporation or association accruing while they remain such stockholders, to the extent of the amount of their stock therein, at the par value thereof, in addition to the amount invested in such shares."[3]

§ 3003. Whether these Constitutional Provisions are Self-enforcing.— Whether affirmative constitutional provisions are self-enforcing, without the aid of supplementary legislation, is a question which has perplexed the judicial courts very much. The question increases in importance, though not in difficulty, year by year, from the well-known habit of constitution-makers putting all sorts of laws into these organic instruments, in obedience to a false popular conception that when a law is once put into the constitution, it is a better law and has more vigor and means of self-enforcement than a mere act of the Legislature; the latter being, in popular conception, often esti-

clause of the Constitution of New York, Constitution of 1846, and of Stat. April 6, 1849. Re Reciprocity Bank, 22 N. Y. 9.

[1] Mich. Const. of 1850, art. 15, § 3, Amend. 1860.

[2] Neb. Const. of 1875, art. 11, § 7.

[3] Wash. Const. 1889–90, art. 12, § 11.

mated to be "no good" until it has been "tested" in the judicial courts. Concerning those *negative prohibitions* in constitutions which form the chief body of the articles of each State constitution, known as the "Bill of Rights," there is, of course, no difficulty; since a prohibition in the organic law of the State is a prohibition in the very highest sense, and is of the very highest force. There would probably be less confusion in the decisions upon the question, so far as it relates to affirmative constitutional provisions, had it not been for a decision of the Supreme Court of the United States, rendered at an earlier day, which leaned very strongly against the proposition that affirmative constitutional ordinances ought to be regarded as self-enforcing.[1] Although that decision was rendered by a divided court, and even then the bench not being full, and is weakened by the fact that Justice Story was one of the dissenting judges, it has been so generally followed as to justify the statement that the courts have gone too far in holding that affirmative constitutional mandates are not self-operative. In line with this judicial tendency are decisions in Missouri holding that the provisions of section 6 of article 8 of the Constitution of Missouri, adopted in 1865, as to the double liability of shareholders in corporations, did not become operative until the taking effect of the act of March 19, 1866, and hence that the double liability did not attach in favor of those who became creditors prior to that date.[2] In line with the same tendency is a decision of the Supreme Court of California, where the court had to decide this question with reference to the second of the two following constitutional ordinances: "Dues from corporations shall be secured by such individual liability of the corporators and other means as may be prescribed by law."[3] "Each stockholder of a corporation or joint-

[1] Groves *v.* Slaughter, 15 Pet. (U. S.) 449.

[2] Blakeman *v.* Benton, 9 Mo. App. 107. So, in effect, ruled in Jerman *v.* Benton, 79 Mo. 149. See, also, Morley *v.* Thayer, 3 Fed. Rep. 737. Upon the analogous question whether a constitutional provision imposing a personal liability upon directors is self-enforcing, see Fusz *v.* Spaunhorst, 67 Mo. 256; reversing *s. c.* 5 Mo. App. 583; Householder *v.* Kansas, 83 Mo. 488; Cummings *v.* Winn, 89 Mo. 51, 56; State *v.* Kelsey, 89 Mo. 623, 630.

[3] Const. Cal., art. 4, § 32.

stock association shall be individually and personally liable for his proportion of all its debts and liabilities."[1] The first, it is perceived, commits the whole subject to the discretion of the Legislature; the second establishes in clear language an individual proportionate liability. The court was confronted with the task of so reconciling the two as to give some effect to both, and found itself unable to do this on any other theory than the theory that neither was self-executing, but that the framers of the constitution decided to commit the whole subject to the Legislature, giving them the direction contained in the second section.[2]

§ **3004. Further of this Subject.** — But it must remain entirely clear that, where a State constitution declares in clear language that the members of corporations shall be individually liable for their debts to a defined extent, it cannot be held that supplementary legislation is required to execute this provision, and hence that the Legislature may leave it forever dormant and inoperative, merely because the framers of the constitution did not go on and prescribe the remedy which should be pursued for enforcing it. A constitution is simply a species of statute, and where a statute declares a right, but fails to prescribe a remedy, the common law, which is fertile in remedies, and one of whose maxims is *ubi jus, ibi remedium*, will step in and supply an appropriate and adequate remedy. This conclusion is thrown into a very clear light by the opinion of Mr. Justice Mitchell, of the Supreme Court of Minnesota, in a recent case, where it was held that the constitutional provision of that State,[3] that "each stockholder in any corporation, excepting those organized for the purpose of carrying on any kind of manufacturing or mechanical business, shall be liable to the amount of stock held or owned by him," is self-executing.[4] And the writer, without further prolonging

[1] Const. Cal., art. 4, § 36.

[2] French *v.* Teschemaker, 24 Cal. 518; Larrabee *v.* Baldwin, 35 Cal. 155, 166.

[3] Const. Minn., art. 10, § 3.

[4] Willis *v.* Mabon, 48 Minn. 140; *s. c.* 31 Am. St. Rep. 626; 50 N. W. Rep. 1110. The court, in a long line of previous decisions, had assumed that such was the nature of the constitutional provision. Dodge *v.* Minnesota &c. Roofing Co., 16 Minn. 368; Allen

this discussion, is content to refer for a statement of his views upon the question to that admirable decision.[1] Where the constitutional provision is that which is found in the constitutions of many of the States, as already seen,[2] reciting that "dues from corporations *shall be secured* by an individual liability of the stockholders, to an additional amount equal to the stock owned by each stockholder, and by such other means as shall be provided by law,"—there can be no question that the provision is not self-enforcing.[3]

§ 3005. Effect of a Constitutional Provision Creating a Double Liability.—In the face of a constitutional provision imposing upon shareholders in all corporations an individual liability for their debts, a general statute authorizing the formation of corporations, without attaching to the stockholders

v. Walsh, 25 Minn. 543; State *v.* Minnesota Thresher Man. Co., 40 Minn. 213; *s. c.* 41 N. W. Rep. 1020; Mohr *v.* Minnesota Elevator Co., 40 Minn. 343; *s. c.* 41 N. W. Rep. 1074; Arthur *v.* Willius, 44 Minn. 409; *s. c.* 46 N. W. Rep. 851; Densmore *v.* Stone Co. (Minn.), 48 N. W. Rep. 528. The decision of the court was strengthened by the fact that such had been the professional understanding of the provision for a third of a century, during which time the question had not been raised. The decision was followed in another case decided at the same time. McKusick *v.* Seymour, 48 Minn. 158; *s. c.* 50 N. W. Rep. 1114.

[1] In Searcy *v.* Little Rock &c. Co., 5 Dill. (U. S.) 348, this subject is briefly referred to. In Missouri &c. R. Co. *v.* Texas &c. R. Co., 10 Fed. Rep. 497, 503, it was held that the following provision of the Constitution of Texas was not self-enforcing: "Every railroad company shall have the right with its road to intersect, connect with, or cross any other railroad." The decision is believed to be untenable. In Bowie *v.* Lott, 24 La. Ann. 214, a constitutional provision that "all lands sold in pursuance of decrees of courts shall be divided in tracts of from ten to fifty acres," required legislation to carry it into effect. In East St. Louis *v.* People, 124 Ill. 655, it was held that a constitutional provision that no municipality should incur any indebtedness without providing for the collection of an annual tax sufficient to pay the interest as it should mature, and to discharge the debt within twenty years, was self-enforcing. In Dupee *v.* Swigert, 127 Ill. 494, it was held that the constitutional provision already set out (*ante*, § 3002), relating to the liability of shareholders in *banking corporations*, was self-executing, and that, by virtue of its inherent power, it ingrafted itself upon every banking law enacted by the Legislature or submitted to the votes of the people.

[2] *Ante*, § 2998.

[3] Morley *v.* Thayer, 3 Fed. Rep. 737. And see French *v.* Teschemaker, 24 Cal. 518, 539.

an individual liability, would, it is said, be unconstitutional, and the persons organized under such an act would acquire none of the rights of a corporation. It was therefore held that an act of the Legislature of California authorizing a municipal corporation to subscribe for stock of a railroad company, the subscription to be made upon the condition that the municipal corporation should not be liable for the debts of the company, and that the provision as to such liability should be made a part of, and be stipulated in, all contracts made by the railroad company for the construction and equipment of the road, did not exempt the municipal corporation from liability for the debts of the railroad company, further than such exemption could be secured by persons contracting with the railroad company expressly stipulating in their contracts to waive all claims against the municipal body for the payment of the debt, and was therefore valid.[1] Such a provision, however, if unconstitutional, was not so essentially interwoven with the scope and objects of the act as to invalidate its other provisions.[2] It would not, for instance, invalidate an organization under a charter which provided that the stockholders should *not* be so individually liable, though the clause would be invalid.[3] It has also been held that such a constitutional guaranty is satisfied by a statute making the stockholders of corporations liable for all debts contracted while they were stockholders. There is nothing in it which requires each man, when he becomes a stockholder, to do so on the penalty of becoming personally responsible for all prior liabilities of the corporation that remained uncanceled; since this would make several different sets of stockholders personally responsible for the same debts, and only one set responsible for others.[4] On the contrary, the clause in the Constitution of Illinois, already set out,[5] making every shareholder in a banking corporation liable to its creditors over and above the amount of his shares, "to an amount equal to his or her

[1] French *v.* Teschemaker, 24 Cal. 518.

[2] Robinson *v.* Bidwell, 22 Cal. 379; Dupee *v.* Swigert, 127 Ill. 494; *s. c.* 21 N. E. Rep. 622.

[3] Aultman *v.* Waddle, 40 Kan. 195.

[4] Larrabee *v.* Baldwin, 35 Cal. 155, 166.

[5] *Ante*, § 3002.

respective shares so held, for all liabilities accruing while he, or she, remains such stockholder," prohibited the Legislature from enacting[1] that "the shareholders of each association formed under the provisions of this act shall be held individually responsible, equally and ratably, and not one for the other, for all contracts, debts, and engagements of such person or association thereof, in addition to the amount invested in such shares"; since the constitution did not create a *proportionate* liability, but under it "every stockholder is liable for the debts of the bank to an amount equal to twice the amount of stock held by him, and may be sued for such amount by any creditor whose claim is large enough to cover it," and "the question of contribution must be settled between the stockholders themselves."[2]

§ 3006. Missouri Constitution of 1865 and Statute thereunder. —Continuing this subject, with the idea that the interpretation of a constitutional provision which has been repealed in the particular State may furnish an analogy for the interpretation of a similar provision in some other State, we find the following provision in the Constitution of Missouri of 1865, since abrogated in that State: "Dues from private corporations shall be secured by such means as may be prescribed by law; but in all cases each stockholder shall be individually liable, over and above the stock by him or her owned, and any amount unpaid thereon, in a further sum at least equal in amount to such stock."[3] Under this provision stockholders are not liable for the debts of the company in full, as in the case of partnership, but only to an amount equal to their stock, together with any unpaid subscription.[4] Railroad corporations, chartered under the Missouri Railroad Corporation Act of 1855, are not subject to the liability imposed by the general corporation act.[5] In other corporations, stockholders were not liable to the

[1] Ill. Laws 1887, p. 89, § 6, cl. 1.

[2] Dupee *v.* Swigert, 127 Ill. 494; *s. c.* 21 N. E. Rep. 622.

[3] Const. Mo. 1865, art. 8, § 6. This provision was abrogated by an amendment adopted November 8, 1870, and the following substituted in its place: "Dues from private corporations shall be secured by such means as may be prescribed by law, but in no case shall any stockholder be individually liable in any amount over or above the amount of stock owned by him or her." Wag. Stat. Mo., 66–69.

[4] State Sav. Asso. *v.* Kellogg, 63 Mo. 540.

[5] Blakeman *v.* Benton, 9 Mo. App. 107.

extent of any unpaid balance on their subscriptions, and to the additional extent of one hundred per cent upon the amount so subscribed by them or upon the stock held by them.[1] The abolition of this double liability, by a constitutional amendment in 1870, left stockholders liable only to the extent of their unpaid stock, and when that was paid up creditors had no further remedy against them.[2]

§ 3007. Effect of Missouri Constitutional Amendment Abolishing this Double Liability. — This double liability was a liability founded in *contract*, and not in the nature of a *penalty;* and when it became fixed it could not be divested by the repealing ordinance, because creditors, having given credit on the face of it, would thereby be deprived of a *vested right.*[3] More fully stated, where the corporation issues negotiable bonds at a time when its shareholders are by law liable to its creditors, in an amount equal to the par value of the stock held by them, in addition to any amount which may be due by them to the corporation in respect of such stock, the holders of such bonds have an action against the stockholders in respect of such superadded liability, notwithstanding that they acquired the bonds *after* the law imposing such liability had been repealed. The bonds having been put upon the market at a time when the double liability of the stockholders of the corporation existed, this liability adhered to the bonds as a part of the security, and continued to attach to them, into whose hands soever they might come, until paid.[4] But as to the effect of the repeal of the double liability clause on bonds which were issued *between* the establishment of the constitutional ordinance imposing such liability and the act of the Legislature putting it into operation, the conclusion was different; since the bonds could not have been issued upon the faith of the double liability clause of the constitution, no legislation having been enacted to carry it into effect;[5] which was

[1] Pickering *v.* Templeton, 2 Mo. App. 424.

[2] Schricker *v.* Ridings, 65 Mo. 208; Gausen *v.* Buck, 68 Mo. 545.

[3] St. Louis &c. Co. *v.* Harbine, 2 Mo. App. 134; following Hawthorne *v.* Calef, 2 Wall. (U. S.) 10.

[4] Blakeman *v.* Benton, 9 Mo. App. 107, 110.

[5] Jerman *v.* Benton, 79 Mo. 148.

tantamount to holding that the constitutional provision was *not self-enforcing*, which, as we have already seen,[1] is, to say the least, a disputable proposition.

§ 3008. **Creditor may Waive Constitutional or Statutory Right to Proceed against Stockholders.** — We have seen that a stockholder may *waive* his vested right not to be answerable, personally, for the debts of the corporation.[2] Can a creditor also waive his right to seek satisfaction of his demand against a stockholder? Whenever nothing further than a question of private right is involved, a person interested in the enforcement of that right may undoubtedly waive it by contract. This general rule, according to Mr. Sedgwick, holds good as well in regard to constitutions as to statutes. "A party," says that able writer, "may waive a constitutional, as well as a statutory, provision made for his benefit." And of this he gives many illustrations, the strongest of which is probably found in the numerous cases which hold that the right of trial by jury may be waived, though guaranteed by the constitution.[3] There is no doubt that a person dealing with a joint-stock company or partnership may make a valid agreement to look for payment, not to the members individually, but only to the social funds.[4] And if a person chooses to deal with a partnership or joint-stock company, upon the terms that its funds, and they only, shall be available to make good his demands, he cannot afterwards depart from those terms and hold the members individually liable, as if no such restriction had been agreed to.[5] One eminent writer regarded it as an open question whether a creditor, who had *notice* of the existence of a stipulation in articles of copartnership limiting the liability of the partners, could charge the partners beyond the limit so expressed on account of debts contracted of him by the firm.[6] One respectable judge has declared, *arguendo*, in distinct terms, that a creditor would be bound by notice of such a stipulation, on

[1] *Ante*, § 3003.

[2] *Ante*, § 2928.

[3] Sedgw. on Const. & Stat. Law, 111.

[4] Story on Part., § 164; *dicta*, in French *v.* Teschemaker, 24 Cal. 518.

[5] Lindley on Part. 302.

[6] Story on Part., § 164.

the ground of having assented thereto;[1] and this seems to have been the law in New York before the adoption by that State, from the French code,[2] of a statute permitting limited partnerships.[3] It is probable that the same rule now obtains in most of the States, as applicable to limited partnerships formed under enabling statutes like that of New York;[4] but as late as the year 1862 it had not obtained a foothold in England, except as to certain joint-stock companies created and registered in conformity with the terms of particular statutes. "So inflexible is the doctrine of unlimited liability" in that country, according to Sir Nathaniel Lindley, "and so important is it that no doubts shall be cast upon it, that judges have frequently denounced, in the strongest terms, the conduct of those who have endeavored to inveigle the public into taking shares in concerns, by asserting that 'no one shall be liable beyond the amount of his subscription.' Nothing can be more delusive or worthless than such statements, as applied to unincorporated bodies: for although the subscribers themselves may stipulate with each other for such a contracted liability, nothing is more clear than that, as to the rest of the world, each partner is liable for the whole amount of the debts of the partnership. Nor will notice that a stipulation of this kind has been entered into between the partners prevent a creditor from holding each of them liable to the full extent of his demand."[5] But whatever the rule may be as to an *implied* waiver by a creditor of his right to proceed for his debt against a stockholder, it has been held that this right, although secured in express terms, may be waived by the creditor by *express* contract;[6] and it is equally free from doubt that it may be waived by *conduct* on the part of the creditor, either at the time of making the contract,[7] or

[1] Crocker, J., in Robinson *v.* Bidwell, 22 Cal. 379, 389.

[2] 3 Kent's Com. 36; Pars. on Part. 527.

[3] Ensign *v.* Wands, 1 Johns. Cas. (N. Y.) 171; Livingston *v.* Roosevelt, 4 Johns. (N. Y.) 251; *s. c.* 4 Am. Dec. 273.

[4] See Pars. on Part. 528.

[5] Lindley on Part., 1st ed., 301.

[6] Robinson *v.* Bidwell, 22 Cal. 379, 388, *per* Crocker, J.; French *v.* Teschemaker, 24 Cal. 518, 539; Basshor *v.* Forbes, 36 Md. 154.

[7] Ohio &c. Ins. Co. *v.* Merchants' &c. Co., 11 Humph. (Tenn.) 1; *s. c.* 53 Am. Dec. 742.

subsequently,[1] indicating a clear understanding between the contracting parties that the creditor is to look only to the corporate funds, and not to the individual liability of the shareholders.

§ 3009. Incorporating Ostensibly for Another Business in Order to Evade the Rule of Individual Liability. — By the Constitution of Minnesota, as amended in 1872, stockholders of corporations rested under an individual liability, to the extent of the stock held by them, for the debts of the corporation, with the exception of stockholders in manufacturing and mechanical corporations. This exception was held to embrace only those corporations which are organized for the purpose, as stated in their articles of association, of carrying on an *exclusively* manufacturing or mechanical business; and if the purposes, as stated in the articles, are to carry on both a manufacturing or mechanical business, and also other kinds of business not properly incidental to or necessarily connected with the manufacturing or mechanical business, the fact that the corporation never actually engaged in such other kinds of business will not bring it within the exception referred to.[2] Nor can the stockholders evade this constitutional rule of liability by incorporating ostensibly for manufacturing purposes under the statute known as the "Manufacturing Corporation Act,"[3] alleging in their articles that they incorporate for manufacturing purposes, when it appears that their primary business is neither a manufacturing nor mechanical business, and that but a small portion of their business is such as properly belongs to a manufacturing or mechanical corporation.[4]

[1] Whitwell *v.* Warner, 20 Vt. 425.

[2] Arthur *v.* Willius, 44 Minn. 409; *s. c.* 46 N. W. Rep. 851.

[3] Gen. Laws Minn. 1873, ch. 11.

[4] Mohr *v.* Minnesota Elevator Co., 40 Minn. 343; *s. c.* 41 N. W. Rep. 1074. It was evident in this case, not only from the business carried on by the corporation, but from the articles themselves, that the scheme of incorporation involved an attempt to evade the individual liability imposed by the constitution. Compare State *v.* Minnesota Thresher Man. Co., 40 Minn. 213; *s. c.* 41 N. W. Rep. 1020.

CHAPTER XLVII.

CONSTRUCTION OF STATUTES MAKING STOCKHOLDERS PERSONALLY LIABLE FOR THE CORPORATE DEBTS.

SECTION
3013. Statutes creating individual liability construed strictly.
3014. Doctrine of strict construction denied.
3015. Cases supporting a remedial construction.
3016. Rule of faithful or sensible construction.
3017. Such statutes, if penal, strictly construed.
3018. What statutes of individual liability penal, and what not.
3019. Statute supplanting one more onerous.
3020. Statutory remedy to be followed.

SECTION
3021. Not construed as retroactive.
3022. Liability governed by statute in force when debt created.
3023. Statutory descriptions of the persons chargeable as stockholders.
3024. Words importing a superadded individual liability to the amount of stock held.
3025. Whether release of corporation under insolvent law releases shareholders.
3026. Individual liability survives in personal representative.
3027. Decisions under particular statutes.

§ 3013. Statutes Creating Individual Liability Construed Strictly. — The courts of several of the States have adopted the rule that statutes creating an individual liability on the part of stockholders to pay the debts of the corporation are in derogation of the common law, and hence to be strictly construed;[1] or, as Thompson, C. J., expressed it, "not to be extended by implication." "It is not to be forgotten," added this careful judge, "that this, as a rule, has no place where the intent is manifest from the words of the law."[2] In the leading case on the subject in Massachusetts, Chief Justice

[1] Gray *v.* Coffin, 9 Cush. (Mass.) 192, 199; Dane *v.* Dane Man. Co., 14 Gray (Mass.), 488; Coffin *v.* Rich, 45 Me. 507, 511; *s. c.* 71 Am. Dec. 559; Moyer *v.* Pennsylvania Slate Co., 71 Pa. St. 293; Appeal of Means, 85 Pa. St. 75, at p. 78; Libby *v.* Tobey, 82 Me. 397; *s. c.* 19 Atl. Rep. 904; Chase *v.* Lord, 77 N. Y. 1; *s. c.* 6 Abb. N. C. (N. Y.) 258; reversing 16 Hun, 369.

[2] Moyer *v.* Pennsylvania Slate Co., 71 Pa. St. 293.

Shaw, in reaching this conclusion, reasoned thus: "To create any individual liability of members for the debt of a corporation, a body politic created by law, and regarded as a legal being, distinct from that of all the members composing it, and capable of contracting and being contracted with as a person, is a wide departure from established rules of law, founded in considerations of public policy, and depending solely upon provisions of positive law. It is, therefore, to be *construed strictly*, and not extended beyond the limits to which it is plainly carried by such provisions of statute."[1] Applying this rule of construction, under a statute providing that the person or property of a stockholder was not thereafter to be taken upon an execution issued against the corporation, "unless a summons in the action was left with the stockholder," it was held that if, pending the determination of the question of the liability of a stockholder who had been summoned, he should die, the proceeding *could not be revived against his executor:*[2] a holding which affords a gross illustration of the doctrine of strict construction.[3]

§ **3014. Doctrine of Strict Construction Denied.** — The view of the preceding cases has no foundation, either in sense or in justice, to rest upon. If the Legislature does not see fit to clothe the adventurers in the enterprise with the franchise of being a corporation, and they nevertheless conjoin their capital in the business venture, they must answer individually and as partners for the debts thereby incurred. The franchise of being a corporation, which gives them this immunity from paying their debts beyond the contribution which they originally make to the enterprise, is a mere *favor* or *benefaction* from the State, which the State can give or withhold at pleasure. This being so, it is plain that the State can give to them the *other* incidents or franchises of a corporation, while withholding *this* from them, and without subjecting them to any

[1] Gray *v.* Coffin, 9 Cush. (Mass.) 192, 199.

[2] Dane *v.* Dane Man. Co., 14 Gray (Mass.), 488. See, also, Ripley *v.* Sampson, 10 Pick. (Mass.) 371.

[3] See to the contrary, both as to reasoning and conclusion, *post*, § 3320.

hardship or doing them any wrong. It is therefore a total confusion of sense and justice to say that, because the State sees fit to clothe a body of coadventurers with all the incidents of a corporation except this one, its *refusal* to clothe them with this one calls for any deviation in their favor from the plain sense of the statutes in construing them. How can a statute demand a strict construction which subjects corporate adventurers to the common lot of other business adventurers, partners and individuals, upon whom the State has not seen fit to confer extraordinary privileges? Whether the doctrine that courts are at liberty, *in any case*, to construe a statute strictly, is sound, must obviously depend on what is understood by the term "strict construction." If we are to understand by it that where a statute is in derogation of the common law, and its terms obscure or ambiguous, courts will not presume that the Legislature intended to repeal the rules of the common law any further than its language necessarily imports, then the rule is harmless; for it means nothing further than that it is the duty of the courts, in every case, to ascertain and carry out the will of the Legislature. But if it means that courts are at liberty, in any case, to refuse to give full effect to the intention of the Legislature, where that intention is plain, or even where it is probable, for no other reason than that the statute invades the common law, then it is manifestly a rule which has no place in the American system of jurisprudence. Such a rule of construction is obnoxious to the charge of *judicial legislation*, which obviously consists not less in partially *repealing* existing statutes by unfriendly rules of construction, than in *supplementing* them by amendatory rules supposed by the courts to be needful. It is a sufficient objection to all attempts of this kind to say that they involve, in every case, an usurpation of authority. The powers of the different departments of the American State governments are strictly defined and separated by written constitutions; and no power of this nature has been committed to the judiciary. In England, where the Parliament was theoretically supreme, and where it was, hence, beyond the power of the judicial courts to declare an act of Parlia-

ment void, this rule afforded, perhaps, the only means which the courts possessed of checking rash and hasty invasions of the judge-made law. But in this country, where the powers of our Legislatures are limited by written constitutions, which limitations are enforced by the courts, and where the courts have not hesitated to declare that there are certain implied restraints on legislative authority in every free country,[1] the same reasons for the rule would seem not to exist. In fact, the rule in this country seems gradually falling into disuse, and it may safely be affirmed that, where a statute is not inhibited by the written constitution, nor a palpable invasion of common right, the courts will always so construe it as to give full effect to the intention of the Legislature.

§ 3015. Cases Supporting a Remedial Construction. — Decisions are not wanting which support the theory of a remedial construction.[2] If the purpose of the Legislature is to keep in view the conserving of the rights of creditors, and to oblige business adventurers to pay their honest debts, it is difficult to see how a court can come to any other conclusion, even where the theory is admitted that a court is at liberty to construe a statute strictly. Mr. Justice Story, at circuit, took this view of the Massachusetts statute of 1821, which made each stockholder severally liable for all the corporate debts, in the following terms: "Every person who shall become a member of any manufacturing corporation which may be hereafter established in this Commonwealth, shall be liable, in his individual capacity, for all debts contracted during the time of his continuing a member of such corporation." He pronounced this statute "confessedly remedial."[3]

1 Calder *v.* Bull, 3 Dall. (U. S.) 386; Wilkinson *v.* Leland, 2 Pet. 267, 656; Loan Asso. *v.* Topeka, 20 Wall. (U. S.) 655, 663.

2 Van Hook *v.* Whitlock, 2 Edw. Ch. (N. Y.) 304, 310; Lane *v.* Morris, 8 Ga. 468, 475.

3 Carver *v.* Braintree Man. Co., 2 Story (U. S.), 432, 437. The reasoning of the Supreme Court of Rhode Island, on a bank charter making the stockholders individually liable for all losses of the capital, etc., distinctly imports a remedial construction in favor of creditors. Atwood *v.* Rhode Island Agricultural Bank, 7 R. I. 376.

§ **3016. Rule of Faithful or Sensible Construction.** — All interpretation is or should be a *faithful effort* to find out the true meaning of the author of the instrument, in its application to the matters under consideration. The doctrine of strict construction is, as carried out in many judicial decisions, an abnegation of this principle, — a manifest attempt on the part of the courts to find out some reason for refusing to administer the law which the Legislature has enacted. The principle, therefore, involves a species of judicial *dishonesty*, which is a reproach to any system of case-made law, and an imputation upon the judges who have made and who administer it. All statutes, including those which are called *penal*, are really *remedial.* They are enacted to *remedy mischiefs;* and those which add the sanction of penalties merely indicate a stronger purpose on the part of the Legislature to suppress the mischief and advance the remedy. It will, therefore, be the effort of judges, if they really mean to be honest, and to put aside the functions of legislators, to construe all statutes, whether they are regarded as penal or as remedial, according to the meaning of the Legislature, as found in the language of the instrument. One court has aptly expressed this rule by saying, in a case where it was sought to charge stockholders with a statutory liability, that it is the better way to read the provisions of the statute *as the court thinks they were intended to be read,* and then to apply them to the actual facts. "In pursuing this course," said Graves, J., "we must suppose that, the mind of the Legislature, being specially drawn to the subject of departing from the regulations of the common law in regard to the liability of corporators, and conceiving a purpose to make certain members responsible for company liabilities, the extent of the departure and the class of liabilities, if less than all, and the limitations and conditions, if any, would naturally be indicated with some distinctness, and we should expect to find in the terms and arrangements of the statute, without straining or refinement, the real sense of the Legislature. Whether, in our judgment, the Legislature went too far, or did not go far enough, is not for us to consider. The scope of our duty is to ascertain just how far the law-makers went, and then to pause

precisely where they did. In studying the provisions here, with this object, we are forced to think that the expressions used to denote the conditions of the stockholder's liability are to be taken in their natural and ordinary sense."[1] "We must," said Kent, J., in a case arising under a similar statute, "take the law as we find it, and construe it according to its plain import. We cannot go beyond this, and base our decision upon arguments drawn from expediency, or from what we might deem inconveniences, or even hardships."[2] "It is only when the words of a statute are obscure or doubtful," said the same court in another case, "that we have any discretionary power in giving them a construction, or can take into consideration the consequences of any particular interpretation."[3] In a similar case in Georgia, Lumpkin, J., said: "It is not for this court to *add to or take from* the words of the act. . . . . . We are content to incur the reproach implied in the old saw, that he who sticks to the letter of the statute looks only *skin-deep* into its meaning. If the *color* clearly indicates the species to which it belongs, we care not to extend our researches any further. We reiterate our abhorrence of judicial legislation. The first, last, and only inquiry of courts should be, What saith the law? — and, when the response is received, fearlessly to administer it, leaving it to the Legislature to cure such defects as time may have produced or experience detected."[4] Further on, the same learned judge discussed the purposes of the Legislature in making each stockholder of a bank liable to redeem his *pro rata* of its outstanding circulation, and pronounced it "a most commendable policy"; and said, "it is not for us to hinder and thwart its salutary operation."[5]

[1] Bohn *v.* Brown, 33 Mich. 257. The Supreme Court of California, called upon to expound such a statute, proceeded to give it what was deemed "a just and reasonable construction." Mokelumne Hill &c. Co. *v.* Woodbury, 14 Cal. 265; Davidson *v.* Rankin, 34 Cal. 503, 505.

[2] Ingalls *v.* Cole, 47 Me. 530, 540.

[3] Coffin *v.* Rich, 45 Me. 507, 511; *s. c.* 71 Am. Dec. 559, *per* Davis, J. "If the meaning of statutes is doubtful, the consequences are to be considered in the construction of them; but if the meaning be plain, no consequences are to be regarded, for that would be assuming legislative authority." 4 Bac. Abr. 652.

[4] Lane *v.* Morris, 8 Ga. 468, 475.

[5] *Ibid.*, 478.

§ 3017. Such Statutes, if Penal, Strictly Construed. — There is, in the opinion of courts, more reason for the existence of a rule of strict construction under statutes which seek to charge stockholders with liability for the debts of the corporation because of the omission to perform some specific act (as in the cases below quoted), for in such cases the statutes are penal in their nature.[1] But even here it is believed that the rule, properly understood and applied, so as not to transcend the scope of judicial power, goes no further than to hold that, where the statute is penal, courts will hesitate more about enlarging the meaning of doubtful terms than where it is remedial. Thus, under a statute making directors liable in their individual capacity for debts of the corporation contracted during their administration, above the amount of the capital stock paid in, where a stockholder had been compelled to pay debts of the corporation, the directors were not liable over to him, nor were they liable to any person unless the indebtedness existing *at one time* exceeded the amount of stock paid in.[2] But there is ordinarily but little room for the application of this supposed principle; since, as a general rule, statutes creating an individual liability on the part of the members of a corporation to pay its debts are *not penal*.[3] They fall within the elementary conceptions of a remedial statute. The mischief to be remedied is the wrong of business adventurers being allowed to contract debts without paying them; and it is the obvious duty of courts of justice (unless they are misnamed) so to construe such a statute as to suppress the mischief and advance the remedy.

§ 3018. What Statutes of Individual Liability Penal and what not. — It has been held that a statute making stockholders individually liable for certain *contracts which it expressly forbids* the corporation to make, is not to be regarded as making them liable as on contract, but creates a liability

[1] Garrisen *v.* Howe, 17 N. Y. 458, 466; Cable *v.* McCune. 26 Mo. 371; *s. c.* 72 Am. Dec. 214.

[2] Kritzer *v.* Woodson, 19 Mo. 327.

[3] *Post*, §§ 3040, 3050.

in the nature of a *penalty*.[1] So, a statute making the stockholders liable to pay the debts of the corporation contracted while it is *in default in publishing a notice* of the state of its affairs therein provided for, has been held to be *penal* in its character.[2] As the Legislatures have for the most part thrown down the bars to the creation of corporations, in some States allowing corporations to be formed for the prosecution of any lawful business,[3] the judges in later cases have more sensibly felt the necessity of upholding statutes enacted to protect the creditors of such bodies from the dishonesty of their managers. They are, at least, substantially agreed in one thing: that an *ordinary double or individual liability* imposed upon a stockholder for the debts of the corporation *is not in the nature of a penalty*, but springs out of *contract*.[4]

§ 3019. Statute Supplanting One More Onerous.—The rule that such statutes will, in general, be strictly construed in favor of stockholders implies that if the statute was designed to relieve stockholders of an onerous burden imposed by a previous statute, it will be entitled to be construed *remedially* in their favor. Such was the construction placed upon a statute of Illinois, relieving members of plank-road companies from liability beyond the amount of stock subscribed.[5] Such, also, was the rule applicable to a statute of Massachusetts, requiring stockholders to be summoned, in suits against the

[1] Lawler *v.* Burt, 7 Ohio St. 340. To similar effect, Sturges *v.* Burton, 8 Ohio St. 215; *s. c.* 72 Am. Dec. 582; Bird *v.* Hayden, 1 Rob. (N. Y.) 383; *s. c.* 2 Abb. Pr. (N. S.) 61; *post*, § 4175, *et seq.*

[2] Cable *v.* McCune, 26 Mo. 371; *s. c.* 72 Am. Dec. 214. See, also, Sayles *v.* Brown, 40 Fed. Rep. 8; *post*, § 4221, *et seq.*

[3] *Ante*, § 164.

[4] Hodgson *v.* Cheever, 8 Mo. App. 318; Manville *v.* Edgar, *Id.* 324; Bagley *v.* Tyler, 43 Mo. App. 195; Norris *v.* Wrenchall, 34 Md. 492; Aultman's Appeal, 98 Pa. St. 505. See, as showing that the liability is *contractual*, Wright *v.* McCormack, 17 Ohio St. 86; Brown *v.* Hitchcock, 36 Ohio St. 667; Hawkins *v.* Furnace Co., 40 Ohio St. 507; Hawthorne *v.* Calef, 2 Wall. (U. S.) 10. But see Rice *v.* Merrimack Hosiery Co., 56 N. H. 114, where the court, in refusing to enforce the liability of stockholders, in an Ohio corporation, for all debts due to laborers, declared it to be a "mere creature of statute, having none of the elements of contract, whether express or implied."

[5] Gay *v.* Keys, 30 Ill. 413.

corporation, when it was sought to charge them personally, and permitting them to appear and defend; whereas the previous law allowed the creditor, upon a mere judgment against the corporation, to levy on the body and goods of any stockholder, although he had not previously had an opportunity to contest the question of his liability.[1]

§ 3020. Statutory Remedy to be Followed. — The rule of *strict construction,* already alluded to,[2] exacts that the remedies prescribed by statutes creating an individual liability on the part of officers and members of corporations for the corporate debts must be strictly followed; and such is the general doctrine.[3] But this rule of practice does not necessarily imply a rule of strict construction. It may be made to rest on the ground that neither at law nor in equity, except as heretofore pointed out,[4] are the members of a corporation liable to pay the debts of the company; that these statutes are hence to be regarded as creating a new right, and prescribing a remedy to enforce the same, in which case the familiar rule is that the particular remedy must be pursued.[5] But if they are to be regarded as merely preserving an old right, by withholding from the incorporated associates the immunity from personal liability which is generally granted, and by continuing, to the

[1] Holyoke Bank *v.* Goodman Paper Co., 9 Cush. (Mass.) 576, 582.

[2] *Ante,* § 3013.

[3] Chamberlin *v.* Huguenot Co., 118 Mass. 532, 536; Priest *v.* Essex Hat &c. Co., 115 Mass. 680; Ripley *v.* Sampson, 10 Pick. (Mass.) 371; Knowlton *v.* Ackley, 8 Cush. (Mass.) 93, 97; Grose *v.* Hilt, 36 Me. 22; Bassett *v.* St. Alban's Hotel Co., 47 Vt. 313; Windham Prov. Inst. *v.* Sprague, 43 Vt. 502; Dauchy *v.* Brown, 24 Vt. 197; Diven *v.* Lee, 36 N. Y. 302; *s. c.* 34 How. Pr. 197; Youghiogheny Shaft Co. *v.* Evans, 72 Pa. St. 331, 334; Lowry *v.* Inman, 46 N. Y. 119; Peck *v.* Coalfield Coal Co., 3 Ill. App. 619; Fourth Nat. Bank *v.* Franklyn, 120 U. S. 747; Erickson *v.* Nesmith, 15 Gray (Mass.), 221; Kelton *v.* Phillips, 3 Met. (Mass.) 61; Leland *v.* Marsh, 16 Mass. 389; Child *v.* Coffin, 17 Mass. 74; Andrews *v.* Callender, 13 Pick. (Mass.) 484; Moies *v.* Sprague, 9 R. I. 541; Savings Asso. *v.* O'Brien, 51 Hun (N. Y.), 45. Compare Pollard *v.* Bailey, 20 Wall. (U. S.) 520; Terry *v.* Little, 101 U. S. 216; Stone *v.* Wiggin, 5 Met. (Mass.) 316.

[4] See *ante,* § 2925.

[5] Brinham *v.* Wellersburg Coal Co., 47 Pa. St. 43, 49; Dauchy *v.* Brown, 24 Vt. 197; Erickson *v.* Nesmith, 15 Gray, 222; Pollard *v.* Bailey, 20 Wall. (U. S.) 520; Allen *v.* Walsh, 25 Minn. 543; Johnson *v.* Fischer, 30 Minn. 173; Fourth Nat. Bank *v.* Francklyn, 120 U. S. 747, 756.

extent prescribed, their personal liability to pay their joint debts the same as partners are liable, then it remains that the remedy prescribed, being *statutory and special*, must be followed.[1] And this is consistent with the conclusion that if the constitutional ordinance or statute creating the personal liability points out no remedy, then the proper remedy must be sought for in the principles of the common law or of equity.[2]

§ 3021. Not Construed as Retroactive.—It is familiar law that a statute will not be construed as having a retroactive effect, unless the intention of the Legislature that it shall be so construed appears unmistakably in its terms.[3] This rule, of course, holds in the interpretation of a statute imposing a liability upon stockholders, which did not previously exist, to pay debts of the corporation,[4] or diminishing such liability.[5] If such were the meaning of the statute, it would, according to some holdings, be unconstitutional, as impairing the obligation of contracts.[6] But it has been held that such a statute may well be held to operate upon *existing corporations*, though not as to past transactions.[7]

[1] Hoard *v.* Wilcox, 47 Pa. St. 51, 57.

[2] Householders *v.* Kansas, 83 Mo. 488; Cummings *v.* Winn, 89 Mo. 51; Windham Prov. Inst. *v.* Sprague, 43 Vt. 502.

[3] Seamans *v.* Carter, 15 Wis. 548; *s. c.* 82 Am. Dec. 596; Palmer *v.* Conly, 4 Denio (N. Y.), 374; Hitchcock *v.* Way, 6 Ad. & E. 943; Paddon *v.* Bartlett, 3 Ad. & E. 884; College of Physicians *v.* Harrison, 9 Barn. & C. 524; Whedon *v.* Gorham, 38 Conn. 408, 412; Simonds *v.* Estate of Powers, 28 Vt. 354; Perrin *v.* Sargeant, 33 Vt. 84.

[4] Coffin *v.* Rich, 45 Me. 507; *s. c.* 71 Am. Dec. 559; Carroll *v.* Hinkley, 46 Me. 81; Hathorn *v.* Towle, 46 Me. 302.

[5] Grose *v.* Hilt, 36 Me. 22.

[6] See *post*, § 3032; and compare § 3040.

[7] Gray *v.* Coffin, 9 Cush. (Mass.) 192, 200, construing a statute exonerating executors, etc., from liability, and making the estates in their hands liable. A doubtful interpretation of a statute imposing personal liability on stockholders in behalf of laborers and other such persons, restrained the words, "the stockholders in all companies incorporated in pursuance of the act to which this is a supplement," so as to make them mean in all companies *hereafter* incorporated. Megargee *v.* Wakefield Man. Co., 48 Pa. St. 442. On the contrary, a general statute of Illinois providing that "the *trustees* and corporators of any company organized under this act shall be severally liable for all debts or responsibilities of such company to the amount by him or them subscribed, until the whole amount of the capital stock of such company

§ 3022. Liability Governed by Statute in Force when Debt Created. — It follows that the statutory liability of a stockholder for the debts of the corporation is to be determined according to the law in force when the debt was contracted, and not by a subsequent statute, although the latter statute was enacted before the particular stockholder became such, and although it lessens the liability of stockholders to creditors. The reason rests upon the doctrine often asserted, that when a statute imposes upon stockholders an individual liability for corporate debts, whether to a limited or unlimited extent, this liability enters into the contract of subscription by each stockholder, and forms a part of the security of the creditors of the corporation when the debts are contracted, as fully as if it had been incorporated in the contract, and had been signed by the several subscribers for such stock or by its transferees.[1]

§ 3023. Statutory Descriptions of the Persons Chargeable as Stockholders. — It is scarcely necessary to say that under any theory of statutory construction, — strict or liberal, penal or remedial, — no one can be charged with a statutory liability as a stockholder who does not come within the description given in the statute of the persons chargeable.[2] When, therefore, an *executor* had invested the funds of an estate in the stock of a bank, without any authority derived from the will or from the law, — it was held that this did not make the *estate* of the decedent a *stockholder* within the meaning of such a statute.[3] Where the statute had imposed a superadded individual liability *upon stockholders*, but an amended act was passed providing that "any *subscriber*," "shall not be responsible beyond the actual amount of stock so by him subscribed, and so much of said law as conflicts herewith, be and the same is hereby repealed," — it was held that the word "subscriber" in the amendatory act should be interpreted to

shall have been paid in, and a certificate thereof recorded," is construed as applying to companies organized, before its passage, under special charters. Arenz *v.* Weir, 89 Ill. 25.

[1] National Commercial Bank *v.* McDonnell, 92 Ala. 387; *s. c.* 9 South. Rep. 149; Gibbs *v.* Davis, 27 Fla. 531, 556; *s. c.* 8 South. Rep. 633.

[2] Diven *v.* Lee, 36 N. Y. 302; *s. c.* 34 How. Pr. (N. Y.) 197.

[3] *Ibid.*

include all stockholders, not only those who were original subscribers to the stock, but those who became owners of it by transfer. The amendatory act, having been intended to relieve against an acknowledged hardship caused by the harsh provisions of the original act, demanded, in the view of the court, a liberal interpretation.[1] The phrase "all the members," in a statute of individual liability, has been held to embrace all persons who are members *at the time when the liability is to be enforced.* In the reasoning of the court, those who become stockholders subsequent to the date of the contract sought to be enforced against them are as fully members of the company as are the earlier associates. The term "members" is held to include all the actual stockholders; for stockholders joining the company take with their membership not only all the benefits, but all the responsibilities which attach to that relation.[2]

§ 3024. Words Importing a Superadded Individual Liability to the Amount of Stock Held. — The provision of the Alabama Constitution of 1868, making a stockholder "liable to the amount of stock held or owned by him," and that of the Alabama Code of 1867, section 1760, making stockholders liable "to the extent of their stock," were held to create a personal or individual liability against corporate stockholders, not only to the extent of their unpaid stock, but for an additional sum equal to the amount of such stock.[3]

§ 3025. Whether Release of Corporation under Insolvent Law Releases Shareholders. — It was held by the Supreme Court of Minnesota, reasoning on general principles, that a judgment discharging a corporation from its debts, under the insolvency law of that State,[4] releases and discharges the stockholders from the individual liability imposed upon them by a provision of the constitution. About two weeks after this

[1] Gay *v.* Keys, 30 Ill. 413, 420.

[2] Curtis *v.* Carlow, 12 Met. (Mass.) 3. See, also, Longley *v.* Little, 26 Me. 162; *post,* § 3060.

[3] McDonnell *v.* Alabama Gold Life Ins. Co., 85 Ala. 401; *s. c.* 5 South. Rep. 120.

[4] Minn. Laws of 1881, ch. 148.

decision was rendered, the Legislature of Minnesota enacted a statute, providing "that the release of any debtor under this act shall not operate to discharge any other party liable as surety, grantor, *or otherwise*, for the same debt."[1] It was assumed in one case,[2] and held in another,[3] that the statute prevented the individual liability of stockholders from being released by the discharge of the corporation under the insolvent law. The court rested its conclusion upon the use of the words "*or otherwise*," and, having regard to the circumstances under which the statute had been enacted, refused to restrain those words to the meaning of the preceding words in the sentence, under the so-called rule of *ejusdem generis*.

§ 3026. Individual Liablity Survives in Personal Representative.—Statutes which merely impose upon stockholders an individual liability for the debts of the corporation, not being penal in their nature,[4] the liability thus created does not die with the stockholder, but survives, and may be enforced against his estate in the hands of his personal representative.[5]

§ 3027. Decisions under Particular Statutes.—Some of these will be noted in the margin.[6]

[1] Minn. Laws of 1889, ch. 30.

[2] Tripp *v.* Northwestern Nat. Bank, 41 Minn. 400; *s. c.* 43 N. W. Rep. 60.

[3] Willis *v.* Mabon, 48 Minn. 140; *s. c.* 31 Am. St. Rep. 626; 50 N. W. Rep. 1110.

[4] *Post*, § 3317, *et seq.*

[5] Cochran *v.* Wiechers, 119 N. Y. 399; *s. c.* 7 L. R. A. 553; 29 N. Y. St. Rep. 388; 23 N. E. Rep. 803; Bailey *v.* Hollister, 26 N. Y. 112; Allen *v.* Fairbank, 40 Fed. Rep. 188; Chase *v.* Lord, 77 N. Y. 1; Flash *v.* Conn, 109 U. S. 371; Richmond *v.* Irons, 121 U. S. 27. To the *contrary*, see Dane *v.* Dane Man. Co., 14 Gray (Mass.), 488; and compare Gray *v.* Coffin, 9 Cush. (Mass.) 192, 200; *post*, § 3319.

[6] That Florida Laws 1868, ch. 1639, § 27, were superseded by Florida Acts, 1879, ch. 3165, § 9, see Gibbs *v.* Davis, 27 Fla. 531; *s. c.* 8 South. Rep. 633. That in respect of liability of stockholders, it is immaterial whether a savings bank was organized under Nevada Gen. Stats., §§ 948–974, or under the General Corporation Act (*Ibid.*, §§ 802, 829), see Ross *v.* Bank of Gold Hill, 20 Nev. 191; *s. c.* 18 Pac. Rep. 243. That a member of a joint-stock company is not personally liable for omitting the word "limited" from an indorsement of his name by one of the members, unless he participated or acquiesced therein, see Sellersville Nat. Bank *v.* Banks, 9 Pa. Co. Ct. 92.

CHAPTER XLVIII.

CONSTITUTIONAL QUESTIONS ARISING UNDER SUCH STATUTES.

SECTION
3031. General doctrine: legislative alteration of the charter void.
3032. Statutes imposing individual liability unconstitutional as to existing charters.
3033. Statutes imposing liability for future debts.
3034. Exception where the right of repeal is reserved.
3035. Statutes affecting the remedy merely, not invalid.
3036. What statutes taking away remedies against stockholders have been held valid.
3037. Statutes giving a new or additional remedy to creditors.
3038. Waiver by stockholder of constitutional immunity.
3039. Invalidity of statutes substituting liability of corporation for liability of members.
3040. Statutes repealing individual liability laws, if retroactive, void.
3041. Otherwise in case of stockholders subsequently joining.
3042. Summary remedies not unconstitutional.

§ 3031. General Doctrine: Legislative Alteration of the Charter Void. — The charter of a corporation, when accepted, is a contract between the corporation and the State; and, unless the right of legislative supervision is reserved therein, any subsequent act of the Legislature, which impairs any of the substantial privileges conferred by it, impairs the obligation of a contract, and is hence in conflict with the Constitution of the United States, and void.[1]

§ 3032. Statutes Imposing Individual Liability Unconstitutional as to Existing Charters. — Statutes and State constitutional ordinances imposing, without their consent, an individual liability upon stockholders for the debts of the

[1] Const. U. S., art. 1, § 10; Dartmouth College *v.* Woodward, 4 Wheat. (U. S.) 518; Wales *v.* Stetson, 2 Mass. 143, 146; *s. c.* 3 Am. Dec. 39; Nichols *v.* Bertram, 3 Pick. (Mass.) 342; Nichols *v.* Somerset &c. R. Co., 43 Me. 356; *post*, ch. 117, art. 1.

corporation are unconstitutional, in so far as they operate upon existing charters under which there is no such liability,[1] unless in the original charter, or in some statute or constitutional provision existing and operative at the time of its passage, a power on the part of the Legislature to alter the charter is reserved;[2] and this rule applies, under the same conditions, to corporations which have been organized under general laws.[3]

§ 3033. Statutes Imposing Liability for Future Debts. — It has been held in Maine and Massachusetts that a statute which makes the stockholders of an existing corporation liable for the *future* debts of the corporation, or which discharges them from such liability,[4] does not infringe the chartered franchises of the corporation, but merely regulates the future relations of debtor and creditor, and is hence a valid exercise of legislative power.[5] But the Massachusetts court holds that such a statute would be unconstitutional, in so far as it should attempt to create an individual liability for debts of the corporation already contracted.[6] The view that a distinction, in respect of this question, can be taken between *future* and *past* debts of the corporation, is believed to be untenable.

§ 3034. Exception where the Right of Repeal is Reserved. Where the Legislature passes a general statute authorizing the organization of corporations, and provides for an exemption from individual liability on the part of their members, and, in the statute, reserves the right to alter or repeal it, this is a

[1] Steacy *v.* Little Rock &c. R. Co., 5 Dill. (U. S.) 348 (State constitutional ordinance); Ireland *v.* Palestine &c. Turnp. Co., 19 Ohio St. 369; qualifying Palestine &c. Co. *v.* Wooden, 13 Ohio St. 395; Commonwealth *v.* Cochituate Bank, 3 Allen (Mass.), 42; Fairchild *v.* Masonic Hall Asso., 71 Mo. 526, 534. Compare State *v.* County Court, 51 Mo. 522.

[2] *Ante*, § 89, *et seq.;* Re Oliver Lee & Co.'s Bank, 21 N. Y. 9.

[3] Ireland *v.* Palestine &c. Turnp. Co., *supra*.

[4] Carroll *v.* Hinckley, 46 Me. 81; Hathorn *v.* Towle, 46 Me. 302.

[5] Gray *v.* Coffin, 9 Cush. (Mass.) 192; Coffin *v.* Rich, 45 Me. 507; *s. c.* 71 Am. Dec. 559; Stanley *v.* Stanley, 26 Me. 191. Compare Longley *v.* Little, 26 Me. 162; Wheeler *v.* Frontier Bank, 23 Me. 308; Commonwealth *v.* Cochituate Bank, 3 Allen (Mass.), 42.

[6] Commonwealth *v.* Cochituate Bank, 3 Allen (Mass.), 42.

reservation of the power to alter or repeal all or any one of the terms, conditions, and rules of liability prescribed in the act; and it is competent for the Legislature thereafter to pass an act imposing individual liability upon the members of such corporations, although they were such at the time of the latter act.[1] The State of New York, in the year 1838, established a general banking law, authorizing the formation of banking corporations, one section of which provided that "no shareholder of any such association shall be liable in his individual capacity for any contract, debt, or engagement of such association, unless the articles of association by him signed shall have declared that the shareholders shall be liable." Under this statute a banking association was formed, one of whose articles of association declared that "the shareholders of this association shall not be liable in their individual capacity for any contract, debt, or engagement of the association." It is perceived that this declaration was wholly nugatory, because it declared what the statute under which the corporation was organized had already declared.. Afterwards, an amendment to the constitution of the State and an act of the Legislature declared that shareholders of all banks which should continue to issue circulating notes after January 1, 1850, should be individually responsible for the redemption of the same. It was held that neither the constitutional provision nor the statute was unconstitutional as impairing the obligation of a contract. The reservation in the articles of association did not constitute a contract within the protection of the Constitution of the United States, but was a mere attempt to re-enact a provision of the law, and this without any authority in the general charter so to do. It was not competent for the association to oust the State of its reserved power to alter or repeal the act under which it was created, by establishing such articles.[2] The provision which we have found in so many constitutions,[3] that "dues from corporations

[1] Sherman *v.* Smith, 1 Black (U. S.), 587; affirming *s. c.* Re Oliver Lee & Co.'s Bank, 21 N. Y. 9; followed in Re Reciprocity Bank, 22 N. Y. 9.

[2] Sherman *v.* Smith, *supra.* See, also, Re Empire City Bank, 18 N. Y. 199.

[3] *Ante*, § 2998.

. . . . shall be secured by such individual liability of the corporators, or other means, as may be prescribed by law,"[1] has been held to authorize the passage of a law imposing an individual liability on stockholders of corporations which had been previously chartered, and in whose charter no right of amendment thereof was reserved: the view being that the language was designed to express a reservation of power in the general assembly to provide from time to time by legislation, as experience should suggest or wisdom dictate, for securing dues from corporations by individual liability of the corporators, or by other means.[2]

§ 3035. Statutes Affecting the Remedy Merely, not Invalid. — Whether a given statute, changing the relation of debtor and creditor, reaches the contract, or affects the remedy merely, has been undoubtedly the most perplexing question of constitutional interpretation which has arisen in this country. The Supreme Court of the United States, after a line of decisions in which the pendulum has oscillated very considerably,[3] seem to have rested substantially upon the doctrine that the remedy subsisting when a contract is made is a part of the obligation of that contract in the sense of the Constitution of the United States; so that any subsequent statute of the State which so affects that remedy as substantially to impair or lessen the value of the contract itself, is within the constitutional prohibition.[4] That court has also held that where the governing statute of a corporation creates a personal liability, on the part of its stockholders, to answer for its debts, and provides a special remedy for the enforcement of that liability, it can be enforced by no other remedy in a court of the

[1] Ill. Const., art. 10, § 2.

[2] Weidenger *v.* Spruance, 101 Ill. 278.

[3] This fluctuation of judicial opinion may be traced by a comparison of the following cases: Walker *v.* Whitehead, 16 Wall. (U. S.) 314, 317; Van Hoffman *v.* Quincy, 4 Wall. (U. S.) 535, 550, 552; Green *v.* Biddle, 8 Wheat. (U. S.) 1, 84; Sturges *v.* Crowninshield, 4 Wheat. (U. S.) 122, 200, 201; Mason *v.* Haile, 12 Wheat. (U. S.) 370, 378; Beers *v.* Haughton, 9 Pet. (U. S.) 329, 359.

[4] Edwards *v.* Kearzey, 96 U. S. 595; Seibert *v.* Lewis, 122 U. S. 284, 294.

United States.[1] It is believed to be a sound statement of legal doctrine, based upon a general consensus of judicial opinion, that any subsequent statute which impairs rights already acquired, or creates new grounds of action, or takes away defenses which might be made under existing laws, or imposes new liabilities in respect of past transactions, is unconstitutional.[2] A statute authorizing the *receivers* of banking corporations, against which a perpetual injunction had been ordered, to *make a ratable assessment* upon the stockholders of an amount sufficient to make up the probable deficiencies of funds in their hands for the redemption of the outstanding bills, and affixing a penalty of twelve per cent per annum for non-payment of such assessments, has been upheld as to banks operating under pre-existing charters, on the ground that, looking to previous statutes affecting the liability of the shareholders of the particular bank, it was a modification of the remedy merely. The court conceded that "no constitutional legislation can operate to impose retrospectively increased personal liabilities upon the stockholders."[3]

§ **3036. What Statutes Taking away Remedies against Stockholders have been Held Valid.** — A statute repealing a previous statute, making stockholders liable *to arrest on execution* issued upon a judgment against the corporation, has been held valid as affecting the remedy merely.[4] A statute chang-

[1] Pollard *v.* Bailey, 20 Wall. (U. S.) 520; Fourth Nat. Bank *v.* Francklyn, 120 U. S. 747.

[2] Hope Mut. Ins. Co. *v.* Flynn, 38 Mo. 483; *s. c.* 90 Am. Dec. 438; Provident Sav. Inst. *v.* Jackson Place Rink, 52 Mo. 552; Woart *v.* Winnick, 3 N. H. 473, 477; *s. c.* 14 Am. Dec. 384; Society for Propagation of Gospel *v.* Wheeler, 2 Gall. (U. S.) 105. There is a very clear statement of legal doctrine on this subject in the printed argument of George M. Stewart, Esq., of St. Louis, in the case of Hill *v.* Merchants' Ins. Co., 134 U. S. 515, 520, not the less valuable as a statement of principles from the fact that that able lawyer did not succeed in inducing the court to take his view of their application to the case in hand.

[3] Commonwealth *v.* Cochituate Bank, 3 Allen (Mass.), 42.

[4] Ex parte Penniman, 11 R. I. 333. The decision is supported by those decisions of the Supreme Court of the United States which held that State statutes abolishing imprisonment for debt were valid as to existing contracts. Sturges *v.* Crowninshield, 4 Wheat. (U. S.) 122, 200; Mason *v.* Haile, 12 Wheat. (U. S.) 370; Beers *v.* Haughton, 9 Pet. (U. S.) 329, 359.

ing the remedy of creditors of certain insolvent corporations to a *bill in equity brought by trustees* as the representatives of all the creditors, has been held not unconstitutional, although it prevented creditors from proceeding directly as before: it did not impair the obligation of the creditor's contract, but merely affected his remedy.[1] Upon the analogy of decisions of the Supreme Court of the United States rendered in other relations, it must be concluded that a State statute imposing a period of limitation upon actions against stockholders, where none existed before,[2] or shortening a period already existing,[3] will be upheld, provided in either case there is left a *reasonable period* to the creditor for the bringing of his action.

§ 3037. Statutes Giving a New or Additional Remedy to Creditors. — The same principle upholds the validity of statutes which give a new or additional remedy to creditors of the corporation against its stockholders without increasing the measure of their liability. Thus, the Supreme Court of the United States have held that a State statute which confers upon a judgment creditor of a corporation, when execution on a judgment against the corporation is returned unsatisfied, the power to summon any stockholder who has not fully paid the subscription to his stock, and obtain judgment and execution against him for the amount so unpaid, in no way increases the liability of the stockholder to pay that amount; and, inasmuch as he was before liable to an action at law by the corporation to recover from him such unpaid amount, as well as to a suit in equity, in common with other similar stockholders, to compel contribution for the benefit

But it is to be observed that the court subsequently held that retrospective *homestead and exemption laws*, withdrawing from execution a portion of the property of debtors, were invalid in so far as they operated upon debts created prior to their adoption. Gunn *v.* Barry, 15 Wall. (U. S.) 615; Edwards *v.* Kearzy, 96 U. S. 595.

[1] Story *v.* Furman, 25 N. Y. 214; Commonwealth *v.* Cochituate Bank, 3 Allen (Mass.), 42.

[2] Hawkins *v.* Barney, 5 Pet. (U. S.) 457; Jackson *v.* Lamphire, 3 *Id.* 280, 290; Sohn *v.* Waterson, 17 Wall. (U. S.) 596; Christmas *v.* Russell, 5 *Id.* 290.

[3] Terry *v.* Anderson, 95 U. S. 628, 633. See, also, Terry *v.* Tubman, 92 U. S. 156; George *v.* Gardner, 49 Ga. 441; Samples *v.* Bank, 1 Woods (U. S.), 523.

of creditors, no substantial right of the stockholder is violated.[1] So, it has been held that where the existing statute creates a personal liability on the part of the shareholders for their proportions of the debts of the corporation, and provides that a joint and several action may be instituted to enforce the same, and a subsequent statute enacts substantially the same liability, and, in addition to allowing it to be enforced by an action, gives the corporation the right to *assess the paid-up stock and sell the same*, in case the assessment is not paid, — the latter statute is not invalid; since it does not obligate the stockholder to pay any more than he was required to pay by the former statute, but merely enacts a new and additional mode by which he may be compelled to pay.[2]

§ 3038. Waiver by Stockholder of Constitutional Immunity. — We have seen that a stockholder may *by contract* enlarge his liability to answer for the debts of the corporation,[3] and that a *creditor* of the corporation may, on the other hand, waive his constitutional or statutory right to proceed against its stockholders.[4] Upon the same principle, it has been well held that, while an individual liability for corporate debts cannot be imposed upon a stockholder by a statute passed subsequently to the time when he became such, yet he may waive this constitutional immunity, and become liable by his own consent.[5]

§ 3039. Invalidity of Statutes Substituting Liability of Corporation for Liability of Members. — It is scarcely nec-

[1] Hill *v.* Merchants' Mut. Ins. Co., 134 U. S. 515.

[2] Sparks *v.* Lower Payette Ditch Co., 2 Idaho, 1030; *s. c.* 29 Pac. Rep. 134.

[3] *Ante*, § 2928.

[4] *Ante*, § 3008.

[5] Ireland *v.* Palestine &c. Turnp. Co., 99 Ohio St. 369. Analogy for this doctrine was found in Zabriskie *v.* Cleveland &c. R. Co., 23 How. (U. S.) 381, 400. It is also found in that numerous class of holdings under which shareholders in corporations validate by their acquiescence the voidable acts of the directors and managers, which they might have repudiated if they had acted in time. *Post*, ch. 113. Upon the question what will be *evidence of a waiver* by the stockholders of this constitutional immunity, the opinion of Welch, J., in Ireland *v.* Palestine &c. Co., 19 Ohio St. 369, is instructive in connection with the facts of that case.

essary to say that it is not within the power of the State Legislature, under the constitution of the United States, by granting a charter to the members of a joint-stock company, who are personally liable for its debts, to substitute the responsibility of the joint fund for that of the individual members and the fund, without the consent of the creditors.[1]

§ 3040. Statutes Repealing Individual Liability Laws, if Retroactive, Void. — It is the settled law of this country that a statute,[2] or ordinance of a State constitution,[3] which repeals a former statute which made the stockholders of a corporation individually liable to pay the debts of the corporation, is, as respects creditors *whose debts were contracted prior to its passage,* in derogation of the constitution of the United States,[4] and void. The Supreme Court of the United States have placed this conclusion upon two grounds: 1. Upon the ground of the New York cases,[5] that the stockholder made, or rather *left,* liable by such charters and statutes, stands towards the creditors of the corporation in the relation of a *partner,* and hence of an independent contractor;[6] therefore such a repealing statute impairs the obligation of the contract subsisting *between him and the company's creditors.* 2. That, by the charter or statute subjecting the property of the stockholder to the payment of the corporate debts, the stockholder becomes liable to the creditor in the event of the insolvency of the corporation. This security the creditor has when the debt is contracted. The repealing act does not merely modify it to his prejudice, but abolishes it alto-

[1] Witmer *v.* Schlatter, 2 Rawle (Pa.), 359.

[2] Hawthorne *v.* Calef, 2 Wall. (U. S.) 10; Conant *v.* Van Schaick, 24 Barb. (N. Y.) 87; Rochester *v.* Barnes, 26 Barb. (N. Y.) 657; Story *v.* Furman, 25 N. Y. 214, 223; Norris *v.* Wrenschall, 34 Md. 492, 501.

[3] Provident Sav. Inst. *v.* Jackson Place Skating Rink, 52 Mo. 552; St. Louis Railway Supplies Co. *v.* Harbine, 2 Mo. App. 134; Blakeman *v.* Benton, 9 Mo. App. 107; Ochiltree *v.* Iowa Railroad Contracting Co., 54 Mo. 113; *s. c.* affirmed, 21 Wall. (U. S.) 249; McDonnell *v.* Alabama Gold Life Ins. Co., 85 Ala. 401; *s. c.* 5 South. Rep. 120.

[4] Art. 10, § 1.

[5] Corning *v.* McCullough, 1 N. Y. 47; *s. c.* 49 Am. Dec. 287; Conant *v.* Van Schaick, 24 Barb. (N. Y.) 87.

[6] See *ante,* § 29.

gether, and thereby impairs the obligation of his contract *with the company.*[1]

§ 3041. Otherwise in Case of Stockholders Subsequently Joining. — But such a repeal is valid as to stockholders subsequently joining the company. Thus, the Constitution of Missouri imposed upon stockholders an individual liability. While this provision was in force, the corporation contracted a certain indebtedness. Afterwards, the ordinance imposing an individual liability for the corporate debts was repealed, and still later the corporation increased its stock. It was held that the creditor could not proceed under the repealed ordinance against a subscriber to the increase of stock.[2]

§ 3042. Summary Remedies not Unconstitutional. — Statutes which permit an execution on a judgment against a corporation to be levied on the body and goods of a stockholder, are not unconstitutional. They are not to be deemed to authorize a man's estate or body to be taken without a judgment against him, or without a hearing in the action upon which the judgment was rendered. If they were so, they would, undoubtedly, be void. But, on the contrary, all who are members of the corporation are virtually defendants in the action, and have an opportunity to be heard in the form they have chosen by joining the company. As to those who become members after judgment against the corporation, or after the debt has accrued, they voluntarily subject themselves to the inconvenience, having the means to satisfy themselves of the solvency of the company, if they choose to make inquiry. They are in the same predicament as those who become inhabitants of a town after a municipal liability has been incurred.[3]

[1] Hawthorne *v.* Calef, 2 Wall. (U. S.) 10, 22, 23. That this is an *additional security* extended to the creditor is the doctrine of nearly all the cases. Wright *v.* McCormack, 17 Ohio St. 86; Hawkins *v.* Furnace Co., 40 Ohio St. 507, 513; Brown *v.* Hitchcock, 36 Ohio St. 667; Aultman's Appeal, 98 Pa. St. 505. Cases proceeding upon the principle of the text, where the *State was a stockholder*, are: Curran *v.* Arkansas, 25 How. (U. S.) 304; Woodruff *v.* Trapnall, 10 How. (U. S.) 190.

[2] Ochiltree *v.* The Railroad Co., 21 Wall. (U. S.) 249; affirming *s. c.* 54 Mo. 113.

[3] Marcy *v.* Clark, 17 Mass. 330, opinion by Parker, C. J.; Stanley *v.* Stanley, 26 Me. 191.

CHAPTER XLIX.

EXTRATERRITORIAL FORCE OF SUCH STATUTES.

SECTION
3046. Liability of resident stockholders in foreign corporation determined by law of domicile of corporation.
3047. Where the liability is in respect of unpaid shares.
3048. Suit by foreign receiver to enforce this liability.
3049. Stockholder bound by decree in insolvent proceeding without notice.
3050. Individual liability enforced *ex comitate*, unless penal.
3051. Illustrations.
3052. What statutes of individual liability are penal and not enforceable in another State.
3053. Liability of members of migrating corporation.
3054. Where the governing statute of the foreign corporation imposes the individual liability and prescribes the remedy.
3055. Where the foreign statute requires a suit in equity.
3056. This doctrine, how applied in Massachusetts.

SECTION
3057. And in West Virginia.
3058. Applied in Massachusetts so as to deny actions at law given by the law of the domicile of the corporation.
3059. Comments on the Massachusetts doctrine.
3060. Contrary holdings on the same subject.
3061. Ancillary suit in Massachusetts for discovery.
3062. Resident members of resident corporations liable on foreign contracts.
3063. Interpretation of the foreign statute in the foreign forum followed.
3064. Remedy according to the law of the forum.
3065. Whether foreign stockholders entitled to contribution from resident stockholders.
3066. Reviving a judgment against corporation to reach property of non-resident members within the State.

§ 3046. Liability of Resident Stockholders in Foreign Corporation Determined by Law of Domicile of Corporation. — The charter of a corporation, or the statute under which it is organized, furnishes the guide in determining the liability of its stockholders to its creditors;[1] and this is so

[1] Bingham *v.* Rushing, 5 Ala. 403, 406; Lane *v.* Morris, 8 Ga. 468, 474; Shaw *v.* Boylan, 16 Ind. 384; Sumner *v.* Marcy, 3 Woodb. & M. (U. S.) 105; Bank of St. Mary's *v.* St. John, 25 Ala. 566, 620; Smith *v.* Huckabee, 53

where the proceeding is by a creditor of a *foreign corporation* against a resident stockholder: if the stockholder is liable at all, he is, in general, liable only according to the law of the domicile of the corporation.[1] The reason of this rule is obvious. A person guilty of no wrong ought not to be subjected to a burden or liability which he has not voluntarily assumed; and by accepting shares in a foreign corporation a person is rightfully supposed to have had in view the law governing such corporation, and not the law of his own domicile, unless there is such a law specially applicable to his situation.[2] On the other hand, one who accepts shares of stock in a foreign corporation takes upon himself the burden imposed by the charter of such corporation, or the law of its domicile by which it is governed. He is supposed, in a certain sense, to go into the State in which such corporation is domiciled; to cast off for a time the vesture which his own State throws around him, and to put on that of such other State. Nor can he plead ignorance of such laws, any more than one can plead ignorance of the laws of another State when he makes

Ala. 191, 193; Free Schools *v.* Flint, 13 Met. 539; Coffin *v.* Rich, 45 Me. 507, 510; *s. c.* 71 Am. Dec. 559.

[1] Payson *v.* Withers, 5 Biss. (U. S.) 269, 278; Seymour *v.* Sturgess, 26 N. Y. 134; Merrick *v.* Van Santvoord, 34 N. Y. 208, 210; McDonough *v.* Phelps, 15 How. Pr. (N. Y.) 372; Ex parte Van Riper, 20 Wend. (N.Y.) 614; Allen *v.* Fairbanks, 45 Rep. Fed. 445; *s. c.* 9 Rail. & Corp. L. J. 433; Glenn *v.* Liggett, 135 U. S. 533; *s. c.* 34 L. ed. 262; 8 Rail. & Corp. L. J. 52; 10 Sup. Ct. Rep. 867; St. Louis Sav. Asso. *v.* O'Brian, 51 Hun (N. Y.), 45; *s. c.* 20 N. Y. St. Rep. 826; First Nat. Bank *v.* Gustin Minerva Consol. Min. Co., 42 Minn. 327; *s. c.* 18 Am. St. Rep. 510; 6 L. R. A. 676; 7 Rail. & Corp. L. J. 175; 44 N. W. Rep. 198; New Haven Horse Nail Co. *v.* Linden Spring Co., 142 Mass. 349, 353; Hutchins *v.* New England Coal Mining Co., 4 Allen (Mass.), 580; Jones *v.* Sisson, 6 Gray (Mass.), 288; Penobscot &c. R. Co. *v.* Bartlett, 12 Gray (Mass.), 244; *s. c.* 71 Am. Dec. 753; Blackstone Man. Co. *v.* Blackstone, 13 Gray (Mass.), 488; Halsey *v.* McLean, 12 Allen (Mass.), 438, 440; *s. c.* 90 Am. Dec. 157; Nimick *v.* Mingo Iron Works Co., 25 W. Va. 184, 192. Thus, the liability of a stockholder in a corporation created by the Provincial Parliament of Quebec to its creditors is to be determined, in a court of New York, by the laws of that Province. Molson's Bank *v.* Boardman, 47 Hun (N. Y.), 135; *s. c.* 14 N. Y. St. Rep. 658. So, a stockholder of a *national bank* subjects himself to the provisions of the National Bank Act as part of the contract in the bank's charter. Young *v.* Wempe, 46 Fed. Rep. 354.

[2] Merrick *v.* Van Santvoord, 34 N. Y. 208, 210.

a contract to be executed therein.[1] Subject to exceptions hereafter stated, those laws are administered, in the courts, State or Federal, in which the action to charge the stockholder is brought, as *rules of property*, obligatory not only in the State enacting them, but everywhere else.[2] This, of course, supposes that there is no valid and operative legislation in the State of the stockholder's domicile imposing upon him a distinct liability as a stockholder in a foreign corporation, in view of which he has elected to assume that liability.[3] It also supposes that the statute imposing the liability is not *penal* in its nature; for if it is, it will not be allowed to have any extra-territorial operation.[4]

§ 3047. Where the Liability is in Respect of Unpaid Shares.—If the liability of a resident stockholder of a foreign corporation *rests in contract merely*, as in case of the obligation to pay for shares of stock, which he enters into, who has subscribed for them,[5] or who has purchased them from a subscriber or holder before payment,[6] and if the obligation thus assumed is valid and subsisting according to the law of the domicile of the corporation,—it will be good everywhere, and, upon obvious principles, will be enforced in the courts of every other State or country.[7] This proposition, which was penned years ago as a paragraph in the author's work on stockholders, must now be modified to the extent of saying that the rule does not obtain in its full scope in Massachusetts. Here, as in other instances noted in this work, a seemingly narrow and tribal judicial policy withholds remedies against domestic stockholders in foreign corporations, which are conceded in the courts of the United States, and generally in the courts of the other States. There is an exceptional and ill-founded doctrine in that State, as already seen,[8] to the effect

[1] Payson *v.* Withers, 5 Biss. (U. S.) 269, 278.

[2] Allen *v.* Fairbanks, 45 Fed. Rep. 445; Chase *v.* Curtis, 113 U. S. 452; *s. c.* 5 Sup. Ct. Rep. 554.

[3] See Drinkwater *v.* Portland Marine Railway, 18 Me. 35.

[4] *Post*, § 3222.

[5] *Ante*, § 1136.

[6] *Post*, § 3112.

[7] Mann *v.* Coke, 20 Conn. 178.

[8] *Ante*, § 1187; Ripley *v.* Sampson, 10 Pick. (Mass.) 371.

that no personal liability is created by the mere act of *subscribing* for shares in a corporation, unless the subscription paper embodies an *express promise to pay* for them; the general doctrine being that a subscription to shares necessarily *implies* a promise to pay for them. While it is not denied in Massachusetts that in the case of such a subscription to shares in a foreign corporation, embodying an express promise to pay for them, an action can be maintained thereon, yet it is held than an action cannot be maintained in Massachusetts, against a shareholder in a corporation created under the laws of another State, to charge him on the theory of not having paid for his shares, upon an allegation that, upon the organization of the corporation in the foreign State, the shares were paid for partly in money and partly in property, at a valuation which was largely in excess of the real value of the property, which fact was known to the subscriber; and that, under the laws of the foreign State, independently of any statutory or penal liability, a person subscribing for shares in a corporation becomes liable to the corporation to pay for them at their par value, which liability is a part of the assets of the corporation, forms a *trust fund* for its creditors, and may be enforced by any creditor of the corporation.[1] On the other hand, a statute providing that on the return of execution against a foreign corporation unsatisfied, the creditor may sue any debtor to the corporation, the subscribers to its stock, shareholders, or any or all of them, and recover any

[1] New Haven Horse Nail Co. *v.* Linden Spring Co., 142 Mass. 349; *s. c.* 7 N. E. Rep. 773. The doctrine of this case seems narrow, the reasoning of Mr. Justice Devens inconclusive, and the conclusion plainly unjust. We have seen, in dealing with the subject of the payment of shares (*ante*, § 1562), that the general doctrine is as the law of Connecticut was averred to be in the bill which the Massachusetts court repelled. And yet, at the close of the opinion of the court, Mr. Justice Devens says: "If such is the *local law* of Connecticut, and if such a liability may be treated as a debt, this law varies so much from that which ordinarily obtains in regard to similar liabilities, and also in the enforcement of contracts, that we are compelled to leave it to local administration." This is almost a mockery of justice, in view of the fact that the "local administration," — that is to say, the judicial administration of Connecticut, — could acquire no jurisdiction over the stockholders of this corporation domiciled in Massachusetts.

sums, to the amount due the plaintiff, "which said defendant or defendants could be liable to pay in any event in the State or government where such corporation is located," has been regarded as not establishing any new liability on the part of stockholders or debtors of such corporation, but only as making a provision for subrogating creditors of the corporation in the State making the enactment, to such rights as the corporation itself, under the local law, or the *lex loci contractus*, might have enforced against the stockholder or debtor.[1]

§ 3048. Suit by Foreign Receiver to Enforce this Liability. To enforce this contract liability, one suing in a representative capacity, such as the receiver, trustee,[2] or assignee in bankruptcy[3] of a foreign corporation, may maintain his action against the resident stockholder, if the corporation itself could have maintained it, had the stockholder been a citizen of the State in which it was domiciled.[4] Thus, a stockholder of a dissolved New Jersey banking company, in possession of its assets in the State of New York, was held liable to an action by a citizen of that State, a creditor of the bank, although he might be accountable to the foreign jurisdiction in respect of such assets. "The court will not, in such a case," said Mullen, J., "disregard the rights of other parties, but it will ascertain them, and apply that portion which, after investigation, is found to belong to our own citizens."[5]

§ 3049. Stockholder Bound by Decree in Insolvent Proceeding without Notice.—It is no defense by a resident stockholder of a foreign corporation, when thus sued by its represenative, that he had no *notice* of the action in which such representative was appointed. The reason is that when a corporation is sued at the instance of creditors, and duly served, a

[1] Seymour *v.* Sturgess, 26 N. Y. 134.

[2] Howard *v.* Glenn, 85 Ga. 238; *s. c.* 21 Am. St. Rep. 156; 11 S. E. Rep. 610.

[3] Payson *v.* Withers, 5 Biss. (U. S.) 269; Payson *v.* Stoever, 2 Dill. (U. S.) 428.

[4] Seymour *v.* Sturgess, 26 N. Y. 134; McDonough *v.* Phelps, 15 How. Pr. (N. Y.) 372.

[5] Tinkham *v.* Borst, 31 Barb. (N. Y.) 407.

subscriber to the capital stock, although a non-resident and not served with notice, is so far represented by the corporation as to be bound as a corporator by the proceedings and decree rendered therein.[1] In the absence of fraud, such decree is not open to *collateral attack* by the stockholder when sued by the representative of the corporation to collect the assessment thereby ordered.[2] It cannot be impeached, except for *actual fraud*.[3]

§ **3050. Individual Liability Enforced ex Comitate unless Penal.** — If the liability of the domestic shareholder in a foreign corporation exists wholly by virtue of a statute of the foreign State in which such corporation is domiciled, it will be enforced, or not, according to the laws enacted by the Legislature, or the views of policy and comity entertained by the courts of the State of the shareholder's domicile. It is a case for the application of the well-understood principle of law that the legislation of one State has no operation in another State *ex proprio vigore*, but only *ex comitate*.[4] The courts of the State where the laws of such foreign State are sought to be enforced will use a sound discretion as to the extent and mode of that comity. They will not permit their tribunals to be used for the purpose of affording remedies which are denied to parties in the jurisdiction of the State that enacted the law, and which tend to operate with hardship on their own citizens.[5] With reference to the extent to which this comity of States will go, two general propositions, sufficient for the purposes of this discussion, may be stated: 1. If the liability sought to be enforced is in the nature of *contract*, and is not opposed to the legislation or public pol-

[1] Howard *v.* Glenn, 85 Ga. 238; *s. c.* 21 Am. St. Rep. 156; 11 S. E. Rep. 610, and cases cited below.

[2] Hawkins *v.* Glenn, 131 U. S. 319.

[3] Glenn *v.* Liggett, 135 U. S. 533.

[4] Erickson *v.* Nesmith, 15 Gray (Mass.), 221; 4 Allen (Mass.), 233; 46 N. H. 371; Smith *v.* Mutual Life Ins. Co., 14 Allen (Mass.), 336; Halsey *v.* McLean, 12 Allen (Mass.), 438; *s. c.* 90 Am. Dec. 157; Gale *v.* Eastman, 7 Met. (Mass.) 14; Healy *v.* Root, 11 Pick. (Mass.) 389; First Nat. Bank *v.* Price, 33 Md. 487; *s. c.* 3 Am. Rep. 204; Bagley *v.* Tyler, 43 Mo. App. 195.

[5] Rice *v.* Merrimac Hosiery Co., 56 N. H. 114.

icy of the State in which it is sought to be enforced, the courts of such State will give effect to it.[1] 2. If the statute creating such liability is *penal* in its nature, it will not be enforced outside of the sovereignty enacting it.[2] We have already had occasion to examine the question whether statutes of individual liability are penal or remedial,[3] and with the conclusion that, except where imposing such a liability upon stockholders for certain *defaults of the officers or managers*, they are generally regarded as remedial, and spring out of contract. Acting on this principle, the courts of several of the States have enforced against their own citizens, stockholders in foreign corporations, a limited statute liability to creditors, in excess of any amount which might remain unpaid of their stock subscription.[4]

§ **3051. Illustrations.** — Where the charter of a New Jersey bank made its directors jointly and severally liable for all its obligations, the courts of New York sustained an attachment against the property of one of such directors situated in New York, upon the ground of non-residence, the foundation of the action being an indebtedness of the bank.[5] The Legislature of New York passed, in 1845, a statute to facilitate the collection by domestic creditors of debts due by foreign corporations. It provided that, upon the return of an execution against such a corporation, unsatisfied in whole or in part, the creditor might commence a suit against the subscribers to its capital stock, shareholders, or stockholders, or any or all of them,

[1] Hodgson *v.* Cheever, 8 Mo. App. 318, and cases in next section.

[2] Derrickson *v.* Smith, 27 N. J. L. 166; First Nat. Bank *v.* Price, 33 Md. 487; *s. c.* 3 Am. Rep. 204; Halsey *v.* McLean, 12 Allen (Mass.). 438; *s. c.* 90 Am. Dec. 157; Gale *v.* Eastman, 7 Met. (Mass.) 14; Scoville *v.* Canfield, 14 Johns. (N. Y.) 338; *s. c.* 7 Am. Dec. 467; Ogden *v.* Folliot, 3 T. R. 726, 733; State *v.* John, 5 Ohio, 217.

[3] *Ante*, § 3013, *et seq.*

[4] Sackett's Harbor Bank *v.* Blake, 3 Rich. Eq. (S. C.) 225. See, also, Bond *v.* Appleton, 8 Mass. 472; 5 Am. Dec. 111; McDonough *v.* Phelps, 15 How. Pr. 372; Paine *v.* Stewart, 33 Conn. 516, 517; Hodgson *v.* Cheever, 8 Mo. App. 318; Aultman's Appeal, 98 Pa. St. 505; Bagley *v.* Tyler, 43 Mo. App. 195; Saint Louis Sav. Asso. *v.* O'Brien, 51 Hun (N.Y.), 45; *s. c.* 3 N. Y. Supp. 764. The salutary decision of the Supreme Court of the United States in Huntington *v.* Attrill, 146 U. S. 657, goes beyond many of the State decisions, and places the doctrine on its true ground.

[5] Ex parte Van Riper, 20 Wend. (N. Y.) 614.

and might recover in such suit or suits any sums, to the amount due the plaintiff, "which such defendant or defendants could be liable to pay in any event in the State or government where such corporation is located."[1] A plaintiff, being a judgment and execution creditor of a foreign corporation, and bringing himself within the terms of this statute, was required, in order to recover under it, to establish a present debt and liability to the corporation from the person sought to be charged; if as a stockholder, according to the *lex domicilii* of the corporation; if under any other contract, according to the *lex loci contractus*.[2] If, in a proceeding under this statute, there be no proof of a statute of the State in which the foreign corporation is domiciled annexing a liability to stockholders, the common law will be held to apply, and determine their liability.[3] In either case, the correct test is whether the action could have been sustained in the State of the domicile of the corporation if the stockholder had resided there.[4]

§ **3052. What Statutes of Individual Liability are Penal and not Enforceable in Another State.** — Statutes making *directors* liable to pay the debts of the corporation for failing to make and file certain described *annual reports*;[5] or making them liable for contracting, or assenting to the contracting, of corporate debts beyond the amount of capital paid in;[6] or making *stockholders* liable to pay the debts of the company in case of a failure to give a certain notice therein specified;[7] or liable for certain contracts of the corporation which it is forbidden by statute to make,[8]—have been held penal in their nature,[9] and not to be enforced outside of the State enacting

[1] Laws N. Y. 1845, p. 256, ch. 234.

[2] Seymour *v.* Sturgess, 26 N. Y. 134.

[3] Seymour *v.* Sturgess, 26 N. Y. 134.

[4] *Ibid.;* McDonough *v.* Phelps, 15 How. Pr. 372.

[5] *Post*, § 4111; Derrickson *v.* Smith, 27 N. J. L. 166; Halsey *v.* McLean, 12 Allen (Mass.), 438; *s. c.* 90 Am. Dec. 157.

[6] *Post*, § 4175; First Nat. Bank *v.* Price, 33 Md. 487; *s. c.* 3 Am. Rep. 204.

[7] Cable *v.* McCune, 26 Mo. 371; *s. c.* 72 Am. Dec. 214.

[8] Lawler *v.* Burt, 7 Ohio St. 341; Sayles *v.* Brown, 40 Fed. Rep. 8.

[9] Compare, on this point, Sturges *v.* Burton, 8 Ohio St. 215; *s. c.* 72 Am. Dec. 582; Kritzer *v.* Woodson, 19 Mo. 327; Hill *v.* Frazier, 22 Pa. St. 320; Harrisburg Bank *v.* Commonwealth, 26 Pa. St. 451; Andrews *v.* Murray, 33 Barb. (N. Y.) 354; Shaler &c. Co. *v.* Bliss, 34 Barb. (N. Y.) 309; Bough-

them.[1] But under a recent salutary decision of the Supreme Court of the United States, this doctrine does not apply to *judgments* recovered in one State against the directors of corporations for such defaults as those above described; but these are suable in the courts of another State, under that clause of the Constitution of the United States which requires each State to give full faith and credit to the public acts, records, and judicial proceedings of every other State.[2]

§ **3053. Liability of Members of Migrating Corporation.** — An excessive hospitality has clothed the stockholders of a Connecticut corporation doing business in the State of New York with the immunities attaching to their situation under the laws of Connecticut;[3] has enabled citizens of New York to organize themselves into a corporation under the laws of another State for the purpose of doing business in New York, and to enjoy the immunity of corporators in their own State;[4] and has even allowed a foreign corporation domiciled in New York to make an assignment, preferring particular creditors, which a domestic corporation could not do.[5]

§ **3054. Where the Governing Statute of the Foreign Corporation Imposes the Individual Liability and Prescribes the Remedy.** — There is a well-known principle of law to the effect that where a statute creates a right which did not exist at common law, and prescribes a remedy for the enforcement of that right, the remedy so prescribed is exclusive.[6] Whether there is any foundation for the rule in common sense, even

ton *v.* Otis, 21 N. Y. 261; Squires *v.* Brown, 22 How. Pr. (N. Y.) 35, 45; Bird *v.* Hayden, 1 Rob. (N. Y.) 383; *s. c.* 2 Abb. Pr. (N. S.) 61.

[1] Derrickson *v.* Smith, 27 N. J. L. 166; Halsey *v.* McLean, 12 Allen, 439; *s. c.* 90 Am. Dec. 157; First Nat. Bank *v.* Price, 33 Md. 487; *s. c.* 3 Am. Rep. 204; Nimick *v.* Mingo Iron Works Co., 25 W. Va. 184. See, further, *ante*, § 3050, *et seq.*

[2] Huntington *v.* Attrill, 146 U. S. 657; reversing *s. c. sub. nom.* Attrill *v.* Huntington, 70 Md. 191.

[3] Merrick *v.* Van Santvoord, 34 N. Y. 208, 213.

[4] Demarest *v.* Flack, 128 N. Y. 205; *s. c.* 28 N. E. Rep. 645.

[5] Vanderpoel *v.* Gorman, 140 N. Y. 563; *s. c.* 49 Alb. L. J. 158. See 28 Am. Law Rev. 307, 461.

[6] *Post*, § 3055, *et seq.*

in its application to penal statutes, may be doubted. It is believed to have no sound legal reason to rest upon, except that such was the intention of the Legislature. But the intention of the Legislature is to be gathered from the reading of the whole statute, and from a consideration of its history and surroundings. This statement points to the conclusion that the rule cannot exist, in legal reason, as a hard-and-fast rule of statutory interpretation. The rules operate, in many cases, to narrow and restrict legal remedies, and in that way to defeat justice. On the contrary, it is, or at least should be, the policy of the law to enlarge remedies; so that whenever a right is created by a statute, and a remedy prescribed, which remedy cannot be conveniently applied in a foreign forum, that court ought to apply its own remedy for the purpose of saving and enforcing the right. But no rule of statutory interpretation seems to be better settled or more uniformly adhered to than that above stated.[1] The courts of the United States, which treat the States of the Union, in a qualified sense, as foreign jurisdictions, apply this rule of law to actions brought in courts of the United States, to enforce the liability of stockholders created by the statutes of a State; so that no remedy can be applied in a court of the United States except such remedy as would have been admissible in the courts of the State creating the liability.[2] Enlarging this theory, it is, that only the remedy created by the statute which creates the liability can be applied as against the stockholder in a foreign jurisdiction, and not then, when that remedy is a general proceeding in equity, which requires the corporation and all the stockholders to be made parties defendant, and the equities to be adjusted among the several creditors and stockholders.[3]

§ 3055. Where the Foreign Statute Requires a Suit in Equity. — We may then collect considerable judicial authority to the effect that where the statute governing the corporation

[1] Stafford *v.* Ingersol, 3 Hill (N. Y.), 38; Farmers' &c. Bank *v.* Dearing, 91 U. S. 29; Lynch *v.* Merchants' Nat. Bank, 22 W. Va. 554; *s. c.* 46 Am. Rep. 520; Almy *v.* Harris, 5 Johns. (N. Y.) 175.

[2] Patterson *v.* Lynde, 106 U. S. 519.

[3] See next section.

creates an individual liability on the part of its stockholders for its debts, and prescribes a remedy to enforce the same by a *suit in equity* brought on behalf of all the creditors, in which the corporation itself and all the stockholders within reach of the process of the court are made parties, no separate action of any sort, whether at law or in equity, can be maintained, in a State other than that of the domicile of the corporation, against any of its stockholders, however numerous, to charge them with such individual liability.[1] The Supreme Judicial Court of Massachusetts has settled finally upon this doctrine, and has reaffirmed it in recent cases in the following language: "This court does not take jurisdiction of a suit to enforce this liability of stockholders in a foreign corporation, not because it would be a suit to enforce a penalty, or a suit opposed to the policy of our laws, but because it is a suit against a foreign corporation which involves the relation between it and its stockholders, and in which complete justice can be done only by the courts of the jurisdiction where the corporation was created."[2]

§ 3056. This Doctrine, how Applied in Massachusetts. — The Massachusetts court seems to have allowed this principle to operate to exempt the resident stockholders in foreign corporations from the individual liability imposed upon them by the statute law governing the corporation in several cases. In one of these cases a statute of New Hampshire provided that "all legal proceedings hereafter commenced against any individual stockholder in any corporation in this State, for the collection of a debt against said corporation, shall be by bill in chancery, and not otherwise." Some of the shareholders in a New Hampshire corporation resided in Massa-

[1] Erickson *v.* Nesmith, 15 Gray (Mass.), 221; Erickson *v.* Nesmith, 4 Allen (Mass.), 233; Nimic *v.* Mingo Iron Works, 25 W. Va. 184.

[2] Post *v.* Toledo &c. R. Co., 144 Mass. 341, 345; *s. c.* 11 N. E. Rep. 540; 59 Am. Rep. 86; quoted again in Bank of North America *v.* Rindge, 154 Mass. 203, 205; *s. c.* 26 Am. St. Rep. 240. See, also, New Hampshire Horse Nail Co. *v.* Linden Spring Co., 142 Mass. 349, 353, and cases cited, several of which bear upon this question by analogy.

chusetts, and a creditor of the corporation brought an action at law against one of them in Massachusetts to enforce the individual liability created by the New Hampshire statute. It was held, partly on the ground that the remedy by bill in equity prescribed by the New Hampshire statute was exclusive, and that no other remedy could therefore be pursued in Massachusetts,—that the action could not be maintained. But in the opinion of the court, by Bigelow, J., it was conceded that the same remedy prescribed by the New Hampshire statute might be pursued in Massachusetts.[1] Acting upon this hint, the plaintiff subsequently brought a bill in equity in Massachusetts, and was repelled upon the theory set out in another section.[2] That theory was that the bill in equity prescribed as the exclusive remedy by the New Hampshire statute meant a bill in equity *in New Hampshire*, in behalf of all the creditors and against all the stockholders.[3]

§ **3057. And in West Virginia.**—The reasoning of the Massachusetts court has been quoted and formally adopted, and its doctrine applied upon an analogous state of facts, by the Supreme Court of Appeals of West Virginia.[4] In that case a bill in equity was filed against an Ohio corporation and forty-eight of its shareholders, owning a large majority of its shares, in a court of West Virginia, by one of its creditors in his own behalf and in behalf of all the other creditors. The bill showed that the corporation had made an assignment of its assets in the State of Ohio to one of its stockholders, and alleged a state of facts which, if proved, would tend to show that the creditors had exhausted their remedy within the State of Ohio. It appeared that the court in the State of Ohio, which obtained jurisdiction over the administration through the assignee, had been able to bring before it only fifteen of the stockholders, the same being resident in that State, and that all the others were non-residents of

[1] Erickson *v.* Nesmith, 15 Gray (Mass.), 221.

[2] *Ante*, § 3055.

[3] Erickson *v.* Nesmith, 4 Allen (Mass.), 233, 236.

[4] Nimic *v.* Mingo Iron Works, 25 W. Va. 184, 204.

that State. By the law of Ohio, prior to the enactment of section 3260 of the code of that State, the remedy of a creditor, to enforce the individual liability of stockholders, was an action in the nature of a suit in equity for the benefit of all the creditors and against all the stockholders, making the corporation a party defendant;[1] and such, in the view of the West Virginia court, was the effect of this section of the Ohio code. The court affirmed a decree sustaining a demurrer to the bill, but modified it so as to dismiss the bill without prejudice to the institution in West Virginia of any other proper proceeding. The court proceeded upon the impossibility of drawing an entire administration of the assets of the corporation, including the individual liability of its shareholders, into a court in West Virginia; for, although the corporation had been made a party defendant in the court of West Virginia, yet the assignee appointed in the State of Ohio could not be made to account by a court of West Virginia, and this of itself would stand in the way of a complete administration, such as should do justice to all parties.[2]

§ 3058. Applied in Massachusetts so as to Deny Actions at Law Given by the Law of the Domicile of the Corporation. — The same doctrine has been reaffirmed and applied in Massachusetts in a case where the insolvent corporation had been created by the laws of Kansas, and where the proceeding was by a resident of New York against a resident of California, to establish the personal liability of the latter as a stockholder under the laws of Kansas. The action was an action of "contract," which is a statutory action at law in Massachusetts. The declaration, among other things, contained the following averment: "And the plaintiff further says that by the laws of the State of Kansas, if any execution shall have been issued against the property or effects of a corporation, except a railway or religious or charitable corporation, and there cannot be found any property whereon to

[1] Wright *v.* McCormack, 17 Ohio St. 86; Umsted *v.* Buskirk, *Id.* 113.

[2] Nimic *v.* Mingo Iron Works, 25 W. Va. 184, 204.

levy such execution, then execution may be issued against any of the stockholders to an extent equal in amount to the amount of stock by him or her owned, together with any amount unpaid thereon; or the plaintiff in the execution may proceed by action to charge the stockholders with the amount of his judgment, and such plaintiff may maintain an action at law against any one or more of the stockholders of such corporation to recover a debt due by the corporation." It did not set forth any statute of Kansas, nor show to what extent the laws of Kansas, above recited, were statutory or rested merely in judicial decisions; and the Massachusetts court professed some embarrassment for this reason. But it was plain enough that the pleader averred, and intended to aver, that, under the statute law of Kansas, he might have maintained an action at law against the defendant stockholder in the courts of Kansas, if he could have found him within their jurisdiction. The court sustained a demurrer to this declaration, proceeding very much upon the ground taken in its decisions applicable to cases where the remedy within the State of the domicile of the corporation was a remedy in equity.[1]

§ **3059. Comments on the Massachusetts Doctrine.**—It is to be regretted that the Massachusetts court does not, in any of these decisions, suggest a remedy, or whether any remedy at all will be allowed to the creditor of the foreign corporation against such of its stockholders as may happen to reside within the limits of Massachusetts. If those decisions rest upon the ground that suits in equity cannot be sustained against such of the stockholders as reside in Massachusetts, where the law of the domicile of the corporation allows a bill in equity brought in behalf of all its creditors against the corporation and all its stockholders, on the theory that complete justice cannot be done by allowing a separate suit in equity against the stockholders residing in Massachusetts, but that to allow this will operate to do injustice to them,—then the logical conclusion is, that where a general winding-up bill is brought in the State of the domi-

[1] Bank of North America *v.* Rindge, 154 Mass. 203; *s. c.* 26 Am. St. Rep. 240; 27 N. E. Rep. 1015.

cile of the corporation, and a receiver or assignee appointed to collect and administer its assets, this receiver or assignee ought, after an account has been taken, stated, and confirmed, showing the amount which ought to be contributed by each of the several stockholders toward the liquidation of the debts of the corporation and the expenses of the administration, to be allowed to maintain actions at law in Massachusetts, against the several stockholders resident there, for the amounts found due from them respectively as contributories. Such actions, it is perceived, are now allowed in the courts of the United States and in the courts of many of the States.[1] But if, as seems from one of its holdings,[2] the Massachusetts court intends to deny all remedy whatever to creditors of corporations created under the laws of other States against its own citizens, who may be stockholders in such corporations, to enforce not only a statutory superadded individual liability, but also to enforce an equitable liability where there has been merely a sham payment of the shares, then an ineffectual search will be made to discover any principle of law, sense, or justice which will support its conclusion. The doctrine that an action to compel payment of what remains unpaid by the shareholder in respect of his shares is an action depending upon the vigor of the foreign statute, and not upon the contract of the shareholder merely, is a complete fallacy. The foreign statute is merely an enabling act. The foreign Legislature says, to whom it may concern: You may organize yourselves into a corporation, and take unto yourselves certain franchises and immunities, by taking certain steps of procedure, but in so doing you clothe yourselves with certain liabilities. Among these is the obligation of paying for your shares according to your contract, when that payment shall become necessary to liquidate the debts of the corporation. Another is the obligation of paying an equal amount beyond the par value of your shares, in case that amount shall become necessary to liquidate the debts of the corporation. You may have the franchises of a corporation and the immunities of corporators, except that to that extent you shall remain liable as partners. Such a statute is merely an enabling act; no one is obliged to become a member of a corporation under it; no one can be compelled to become under it a shareholder in a corporation against his will.[3] When several adventurers join together, and procure themselves to

[1] *Ante*, § 3049; *post*, §§ 3492, 3568, *et seq*.

[2] *Ante*, § 3056.

[3] *Ante*, § 52.

be incorporated under it, and subsequently contract debts in their corporate name and character, they contract with their creditors to become liable according to the terms of the statute. This is not an implied contract, because an implied contract exists only on a theory of justice under which the law raises the duty of paying a debt when the party has not agreed to pay it. It is an express contract, and it is none the less an express contract because it is not expressed in a few direct words. It is expressed by the statute, and by what the coadventurers have written and done under it, when taken and read together as a whole. And this contract is the contract of the stockholders, and it ought to be, on the principles of the common law, enforceable as a contract in every jurisdiction; and to enforce it as a contract does not import the law of one State into another State and give it an extraterritorial effect, in any proper sense. It merely allows that law to be read for the purpose of determining the contract into which the stockholder has entered. The State of the domicile of the stockholder is extending no comity to the State of the domicile of the corporation, by allowing the contract to be enforced in its courts. But if, in so doing, it is extending a comity to such other State, then the conclusion is equally strong against the propriety of the Massachusetts doctrine. The rule which denies the comity of a remedy to the creditor of the foreign corporation against the domestic stockholder, may become of the most serious character. One can readily understand that a manufacturing corporation might be organized under the laws of New Hampshire to carry on a manufacture there, nearly all of whose stock was held by residents of Boston. In such a case, the operation of this rule would result in a total defeat of the purposes of the statute of New Hampshire governing the corporation. The State of Massachusetts would assume the attitude of saying to the State of New Hampshire: "*Your* comity and generous policy have clothed certain of our citizens with the privileges and immunities of a corporate organization, and have withheld from them none of the advantages flowing therefrom; but *our* comity and policy forbid that they should be subjected to any of the burdens of that situation. If your citizens have given credit to this corporation, on the faith that our comity would compel our citizens, who have enjoyed the fruits of that credit, to respond according to the obligation which they assumed when you made them a corporation, they must take the consequences." The views of the Massachusetts court stand

out in striking contrast with those expressed by an eminent jurist of the State of New York, when delivering the judgment of the Court of Appeals of that State upon a somewhat similar question.[1] Massachusetts is one of the creditor States of the American Union. In proportion to her population her citizens are probably the largest investors in ventures prosecuted by means of corporations organized in other States and countries. This doctrine, which screens her citizens from the liability imposed upon the coadventurers in such corporations who happen to be residents of other States, is grossly unjust; and it is none the less unjust because it is declared in a series of decisions of a court of great learning and reputation, and attempted to be bolstered up by legal theories and reasons. It is an ungrateful return for the facilities afforded by other States and countries to the citizens of Massachusetts for a profitable employment of their surplus capital. Under it, all that a stockholder of a failing foreign corporation will have to do to escape his liability will be to move with his property into Massachusetts; and Massachusetts will thus become the White Friars of dishonest stockholders.

§ **3060. Contrary Holdings on the Same Subject.** — But, as we shall perhaps discover hereafter, judicial authority to the foregoing effect has not been uniform. Thus, in a case in South Carolina, a bill in equity under the New York statute authorizing manufacturing incorporations was maintained against a single stockholder, notwithstanding the objection that all the stockholders were not joined, and that the plaintiff had no right to a decree against the defendant for anything more than contribution after the accounts necessary for the purpose had been stated. But it is very important to note that it appeared, not only that the company was insolvent, but that all the other stockholders had responded for its debts to the extent of their statutory liabilities.[2] So, in a case in Missouri a suit in equity was maintained by a *resident debtor* against a *resident stockholder* of a corporation domiciled in Illinois, which corporation was insolvent, and was undergoing final administration in Illinois by means of a receiver. The plaintiffs had pursued their remedies *at law* in Illinois, had recovered judg-

[1] Referring to Merrick *v.* Van Santvoord, 34 N. Y. 208, 213.

[2] Sackett's Harbor Bank *v.* Blake, 3 Rich. Eq. (S. C.) 225.

ments, and had taken out executions, which were returned *nulla bona*, and the whole assets of the corporation had been placed in the hands of a receiver. The action was to recover unpaid balances upon the share subscription of the defendant.[1] From the foregoing statement, it is plain that the case was badly decided, and that no right of action at all lay in behalf of Missouri creditors, but that the only right of action which existed, being a right assertable only in right of the corporation—the right to call in the unpaid balances due to it from its shareholders as a trust fund for its creditors, and as a part of its equitable assets—had passed to the receiver in Illinois, and consequently could not exist in separate creditors in Missouri, or anywhere else. This difficulty was not suggested by counsel, and was evidently overlooked by the court. There was another difficulty, technical in its nature, and which, it is believed, the court properly disregarded, and that was the difficulty of allowing the plaintiff in a so-called *foreign judgment* to maintain an action thereon in the nature of a creditor's bill.[2] Nor does this conception necessarily exclude the

[1] Shickle *v.* Watts, 94 Mo. 410.

[2] See, as to this doctrine, Claflin *v.* McDermott, 12 Fed. Rep. 375; Tarbell *v.* Griggs, 3 Paige (N. Y.), 207; *s. c.* 23 Am. Dec. 790; Davis *v.* Bruns, 23 Hun (N. Y.), 648. See, however, Hatch *v.* Dorr, 4 McLean (U. S.), 112, and Wilkinson *v.* Yale, 6 McLean (U. S.), 16. The doctrine is narrow and tribal. It has no place except with reference to strictly *foreign* judgments, and it ought not to disfigure the jurisprudence of a collection of sister States, bound together in the closest political, commercial, and social union. It was properly repudiated by the Missouri court in Shickle *v.* Watts, *supra*, Sherwood, J., saying: "The judgments in the case at bar were entitled to full faith and credit in this State (Rev. Stat. 1879, § 2735), and had the same force and dignity, *pro hac vice*, as if domestic judgments. Freem. Judg., § 575. The object of getting the judgments and issuing the executions thereon was to demonstrate that, so far as concerned proceedings against the corporation, the plaintiffs were remediless. The judgments, etc., introduced, established this fact as conclusively as though they were domestic judgments. It has been ruled in this State that, though our statute required judgment of dissolution before proceedings could be had against a stockholder, yet that, where dissolution sufficiently appeared *aliunde*, obtaining a judgment dissolving the corporation was not necessary. State Sav. Asso. *v.* Kellogg, 52 Mo. 583. So, in this case a court, and especially a court of equity, which regards substance and not form, would not require the plaintiffs, having recovered judgments in

right of action in the receiver, assignee, or the other trustee, of a foreign corporation, to recover from the domestic stockholder, in an action at law, an assessment regularly made upon him as a shareholder by the court in the foreign jurisdiction superintending the winding-up proceeding.[1]

§ **3061. Ancillary Suit in Massachusetts for Discovery.** — The Massachusetts court, however, concedes this much to the non-resident judgment creditor of a foreign corporation, — that he may maintain a bill in equity in Massachusetts against the officers of the debtor corporation *for the discovery of the names of its stockholders,* and of the number of shares held by each, where such officers reside in Massachusetts and the books of the corporation are kept there, — to the end that such non-resident creditor may, by a suit in the State of the domicile of the corporation, enforce, under the law of the corporation, a personal liability upon such stockholders as may be caught there. For this concession the foreign creditor ought, perhaps, to render thanks to the State of Massachusetts; but it is to be regretted that there is no clear expression in the opinion of the Massachusetts court of the conclusion that, by any possibility, the evidence so discovered could be used against any of the stockholders domiciled in Massachusetts; although it would seem that the corporation was what is known as a "tramp corporation," being a corporation organized under the laws of Ohio by citizens of Massachusetts, who kept all its books and accounts in Massachusetts.[2]

§ **3062. Resident Members of Resident Corporations Liable on Foreign Contracts.** — The Massachusetts court has also conceded so much as to hold that the resident members of a Massachusetts corporation are liable upon contracts entered into by the corporation in another State with citizens of that

the foreign jurisdiction, which proved unavailable by reason of the insolvency of the foreign corporation, should be required again to go through the same barren and meaningless ceremony in this State, merely because service could be had here on an officer of the insolvent corporation."

[1] *Post,* § 3568.

[2] Post *v.* Toledo &c. R. Co., 144 Mass. 341; *s. c.* 59 Am. Rep. 86.

State, in like manner and to the same extent as upon contracts entered into in Massachusetts with its citizens. Bigelow, C. J., resorted to an argument of considerable length to defend a conclusion of such obvious justice.[1]

§ **3063. Interpretation of the Foreign Statute in the Foreign Forum Followed.** — In all such cases, where the question of the liability of the resident stockholder depends upon the interpretation of the charter or statute of the foreign State by which the corporation was created, or by which it is governed, the court will follow the interpretation which the courts of that State have put upon it, in pursuance of the well-known rule that a foreign tribunal is followed in the interpretation of its own statutes.[2]

§ **3064. Remedy According to the Law of the Forum.** — Upon a well-understood principle, matters pertaining to the remedy follow the law of the forum.[3] A *special remedy* against stockholders, given by the law of the domicile of the corporation, will not be transported, so to speak, into another State for the purpose of applying it against a stockholder found there.[4] But a statute creating, in favor of the creditor of the corporation and against the stockholder, a *common-law liability*, may be enforced in another State by an ordinary action at law.[5] And the general rule, no doubt, is, that where the statute law of the State creating the corporation makes the stockholders liable to its creditors, but without prescribing

[1] Hutchins *v.* New England Coal Co., 4 Allen (Mass.), 580.

[2] Johnston *v.* South Western &c. Bank, 3 Strob. Eq. (S. C.) 263; St. Louis Sav. Asso. *v.* O'Brien, 51 Hun (N. Y.), 45; *s. c.* 3 N. Y. Supp. 764; Merrimac Mining Co. *v.* Levy, 54 Pa. St. 227; *s. c.* 93 Am. Dec. 697. See, also, Franks Oil Co. *v.* McCleary, 63 Pa. St. 317, 319, where the former case is referred to. This doctrine is either stated in terms or conceded in all the decisions. Allen *v.* Fairbanks, 45 Fed. Rep. 445; Chase *v.* Curtis, 113 U. S. 452; *s. c.* 5 Sup. Ct. Rep. 554.

[3] Deadwood First Nat. Bank *v.* Gustin-Minerva &c. Co., 42 Minn. 327; *s. c.* 18 Am. St. Rep. 510; 6 L. R. A. 676; 7 Rail. & Corp. L. J. 175; 44 N. W. Rep. 198.

[4] May *v.* Black, 77 Wis. 101; *s. c.* 45 N. W. Rep. 949.

[5] St. Louis Sav. Asso. *v.* O'Brien, 51 Hun (N.Y.), 45; *s. c.* 3 N. Y. Supp. 764.

the mode of making this liability available to them, the course of proceeding in another State must be regulated by the law of that State.[1] A disgraceful decision in New Hampshire denied a creditor of an Ohio corporation a remedy, on the ground that the bill did not show by what remedial process the individual liability of stockholders was enforced in Ohio;[2] and a court of the United States has held, upon what tenable theory it is hard to understand, that the fact that an execution by a creditor of an insolvent corporation, on a judgment obtained in the State of its organization, has been returned unsatisfied, will not entitle him to maintain a bill in another State, where no judgment has been recovered, to compel payment by a stockholder of the amount of his subscription to the capital stock.[3] No sound reason is perceived why a special remedy given by statute against stockholders in corporations generally should not be available against a resident stockholder in a foreign jurisdiction, where the foreign statute creates a *right* to which the domestic statute may appropriately supply the remedy. Accordingly, we find a recent holding to the effect that a judgment debtor of a *foreign corporation*, after return of execution unsatisfied, may sue a stockholder indebted to the corporation for an unpaid subscription to its capital stock, under the provision of the New York Code of Civil Procedure,[4] that where execution has been returned unsatisfied, the creditor may maintain an action against the debtor, or any other person, to compel the discovery of property or money due the debtor, to procure satisfaction of his demand.[5]

§ 3065. Whether Foreign Stockholders Entitled to Contribution from Resident Stockholders.—A recent and unjust Federal decision is to the effect that where the foreign statute which gives the liability is *penal*,—as where it imposes a joint

[1] Drinkwater *v.* Portland &c. R. Co., 18 Me. 35. Compare Kersell *v.* Marshall, 1 Com. B. (N. S.) 241.

[2] Rice *v.* Merrimac Hosiery Co., 56 N. H. 114.

[3] Globe Rolling Mill Co. *v.* Ballou, 42 Fed. Rep. 749.

[4] N. Y. Code Civ. Proc., § 1871.

[5] Persch *v.* Simmons, 3 N. Y. Supp. 783.

and several liability for the failure to file a certificate stating the amount of the assessments voted by the company and actually paid in, and the amount of all existing debts, — the stockholders residing in the State of the domicile of the corporation against whom the liability has been enforced cannot maintain a suit in equity against stockholders in another State for contribution.[1] It is hard to conceive of any ground under which this decision is tenable, unless all the stockholders are to be regarded as joint tort-feasors, which plainly cannot be sustained in any case where the default is that of the managers merely. The stockholders thus exempted from the obligation of contribution may be the very ones who committed the statutory default. For instance, there is a Missouri railroad corporation which was lately owned in New York and by one man. He named his directors, who were merely his dummies. Suppose that in such a case such a default should occur, and insolvency supervene. The few Missouri stockholders would be liable under this statute for *his* default, and could not even get contribution from him. But where a statute of the State in which the corporation is domiciled allows an execution to be issued against any stockholder that may be found within the jurisdiction, upon an order of court, procured upon notice and a hearing, upon a *motion* made by a judgment creditor of the corporation,[2] — he is, upon common principles of equity, entitled to contribution from the other shareholders;[3] and there is no good reason why this right should be denied or impeded from the mere fact that the stockholders from whom he seeks to enforce it are residents of another State. A court of the United States will, at least, allow him to maintain a suit in equity against such non-resident stockholder for contribution;[4] and this, although the proceeding under which he was compelled to pay the debt of the judgment creditor of the corporation would not have been

[1] Sayles *v.* Brown, 40 Fed. Rep. 8.

[2] Such was the Missouri statute in the case under consideration. *Post*, § 3602.

[3] As to this right of contribution in equity in general, see Deering *v.* Winchelsea, 2 Bos. & P. 270; *post*, § 3816.

[4] Allen *v.* Fairbanks, 45 Fed. Rep. 445.

maintainable against the non-resident shareholder from whom he seeks contribution.[1]

§ 3066. Reviving a Judgment against Corporation to Reach Property of Non-resident Members within the State.— It has been held that where a party recovers judgment against a corporation, or some of its members, after it is dissolved, and such party dies, and some of the members are non-residents, if there are any effects of the corporation in the State, or any *debts due to such non-resident members by residents in the State,* a court of equity may revive the judgment, and subject the effects, etc. But if there are no effects within the jurisdiction, the non-residents cannot be reached.[2]

[1] Allen *v.* Fairbanks, 45 Fed. Rep. 445.

[2] De Wolf *v.* Mallett, 3 Dana (Ky.), 214, 218.

CHAPTER L.

STATUTE CREATING A JOINT AND SEVERAL LIABILITY AS PARTNERS.

SECTION
3071. Classification of the statutory liability of stockholders.
3072. Nature of the liability of partners.
3073. Stockholders so liable until organization perfected and capital paid in.
3074. Other cases where they are liable as partners.
3075. "Double liability," when regarded as that of partners.
3076. Liability as partners attaches to members who are such when debt contracted.
3077. Liability as partners that of principal debtors, not that of guarantors or sureties.
3078. Direct action against the members as partners.
3079. Limitation runs from contracting of debt.
3080. Liability several as well as joint: assets of deceased stockholders liable.
3081. Unlimited several liability without right of contribution.
3082. Liability of stockholder not merged by judgment against corporation.

§ 3071. Classification of the Statutory Liability of Stockholders. — The policy has taken root in many of the American States of charging stockholders in corporations with a liability greater than that which attaches to them under the rules of equity. An examination of these statutes will show that some of them are, so to speak, merely declaratory of the common law; that is, they attach to the stockholder no other or greater liability than that which attaches to him under the principles of equity already set forth. It will further appear that the liability which other statutes ascribe to stockholders, in excess of their general liability in equity, which I shall term their *contract* liability, is of four sorts: 1. A *joint* and *several* liability as *partners;* 2. A *joint* and *several* liability as *guarantors;* 3. A *limited several* liability; 4. *An unlimited several liability.*

§ 3072. Nature of the Liability of Partners. — 1. Let us first notice those charters and statutes which, in the creation and regulation of corporations, ascribe to their members an unrestricted liability as partners. It will be necessary, at the outset, to inquire what are the liabilities of general partners to the creditors of the partnership firm. This question has been answered with the greatest clearness and propriety by Lord Justice Lindley, in his much-approved work on the Law of Partnership, as follows: "By the common law of this country, every member of an ordinary partnership is liable, to the utmost farthing of his property, for the debts and engagements of the firm. The law, ignoring the firm as anything distinct from the persons composing it, treats the debts and engagements of the firm as the debts and engagements of the partners, and holds each partner liable for them accordingly. Moreover, if judgment is obtained against the firm for a debt owing by it, the judgment creditor is under no obligation to levy execution against the property of the firm before having recourse to the separate property of the partners; nor is he under any obligation to levy execution against all the partners ratably, but he may select any one or more of them, and levy execution upon him or them, until the judgment is satisfied, leaving all questions of contribution to be settled afterwards between the partners themselves."[1] It is scarcely necessary to say that where a corporation has been lawfully formed, its stockholders are not *partners*, even as amongst themselves, unless the governing statute makes or leaves them so.[2]

§ 3073. Stockholders so Liable Until Organization Perfected and Capital Paid in. — As already seen,[3] this liability

[1] Lindley on Part. 300. "In cases at law," says Professor Parsons (Pars. on Part. 350, note), "there has never been a doubt of the immediate liability of each partner to have the judgment against the firm fully satisfied from his assets, or of his liability *in solido*." To this he cites, Woolley *v.* Kelly, 1 Barn. & C. 68; Herries *v.* Jamieson, 5 Term Rep. 553, 556; Lord Eldon, in Ex parte Ruffin, 6 Ves. 119; Abbott *v.* Smith, 2 W. Black. 949, *per* De Grey, C. J.; Jones *v.* Clayton, 4 Maule & S. 349; Villa *v.* Jonte, 17 La. Ann. 9; Nicholson *v.* Janeway, 16 N. J. Eq. 285.

[2] Baker *v.* Backus, 32 Ill. 79.

[3] *Ante*, § 2969.

attaches to members of corporations as to those debts contracted before they had so far perfected their corporate organization as to clothe themselves with the immunities attaching to members of corporations.[1] Thus, until the capital stock of a corporation, as fixed and limited by the articles of association, under the General Statutes of Massachusetts, chapter 61, has been divided into shares, the members hold the whole capital in common, and, by reason of such holding, may be individually liable, under another statute,[2] for the debts of the company.[3] So, under a charter providing that "until $30,000 of the capital stock shall have been paid in, every stockholder shall be held individually liable for the debts of the company," the stockholders are liable to be sued as partners, and not as guarantors;[4] and hence the remedy of a *creditor*, who was *also a stockholder*, was in equity and not at law.[5] Although this liability is in many cases declared by statute,[6] it cannot be regarded in all cases as *special* and *statutory;* since before there has been a *de facto* organization, the stockholders are liable as partners under the general principles of law.[7] But when such an organization has been perfected, their liability, on the ground that their authorized capital stock has not been taken, must be sought for in the statute law, or it may safely be affirmed that it does not exist at all.[8]

[1] Broyles *v.* McCoy, 5 Sneed (Tenn.), 602.

[2] Mass. Stat. 1862, ch. 218.

[3] Hawes *v.* Anglo-Saxon Co., 101 Mass. 385; 111 Mass. 200; First Nat. Bank *v.* Almy, 117 Mass. 476.

[4] Perkins *v.* Sanders, 56 Miss. 733.

[5] *Ibid.; post,* § 3446.

[6] *Ante,* § 2983.

[7] *Ante,* §§ 218, 2969.

[8] To illustrate: The charter of the Southern Ohio Canal Company, incorporated by a special act of the Legislature of Kentucky, with power to mine coal without and within Kentucky, authorized the company to borrow money in the prosecution of its business, and declared that its capital stock should consist of $300,000, divided into shares of $100 each, to be subscribed and paid for in such manner *as the by-laws* of the company might prescribe. The corporation engaged in mining coal in Ohio, and when only $120,000 of the capital stock was taken, its president, who was one of the incorporators, executed a note payable to B., its secretary and treasurer, for $7,500, for money loaned to the company, which B. indorsed to a bank, informing its cashier that the company was a corporation. In an action by the bank, on the note, against the stockholders as partners, it was held that they were not liable. First Nat. Bank *v.* Hall, 35 Ohio St. 158.

§ 3074. Other Cases where They are Liable as Partners. The stockholders of incorporated companies have been held liable as partners, precisely as though they had not been incorporated, under a charter provision declaring them liable individually "in the same manner as *carriers at common law* for the transportation of all goods," etc.;[1] under a charter making them personally liable, "at all times, for all debts due by said corporation,"[2] though this liability attached only to those who were members of the corporation *when the suit was brought;*[3] under a charter making them personally liable, "provided said corporation shall become insolvent," etc.,—their liability as joint debtors or copartners attaching whenever the corporate responsibility fails;[4] under a charter providing that, "for want of corporate property whereon to levy execution, the stockholders who were such at the time the contract was made, or liability incurred, shall be liable in their own persons and estates as if the contract had been made, or liability incurred, by them personally,"—the liability, as in other cases of partners, subjecting them either to actions jointly at common law, or jointly and severally in equity, and subject to all the incidents of partnership liability;[5] under a statute making the stockholders, "jointly and severally, personally liable for all debts or demands contracted by the said corporation,"—imposing upon them a more onerous liability than though they had not been incorporated, in so far as it makes them *severally*, as well as jointly, liable, but subject to the favorable condition that the assets of the corporation must be exhausted before proceeding against them;[6] under a statute making the stockholders of a railroad com-

[1] Allen *v.* Sewall, 2 Wend. (N. Y.) 327; reversed on other grounds, 6 Wend. (N. Y.) 335.

[2] Southmayd *v.* Russ, 3 Conn. 52.

[3] Middletown Band *v.* Magill, 5 Conn. 28. But this holding was probably untenable. *Post,* § 3173. For a description of these two cases, in which the judges were much divided, see Thomp. Stock. § 28.

[4] Deming *v.* Bull, 10 Conn. 409, 415.

[5] New England Commercial Bank *v.* Stockholders, 6 R. I. 154; *s. c.* 75 Am. Dec. 688.

[6] Harger *v.* McCullough, 2 Denio, 119; Corning *v.* McCullough, 1 N. Y. 47; *s. c.* 49 Am. Dec. 287; Moss *v.* Averell, 10 N. Y. 449, 459; Moss *v.* Oakley, 2 Hill (N. Y.), 265.

pany "jointly and severally liable for all the debts due or owing to any of its laborers and servants," etc.;[1] under a statute making each shareholder "individually and personally liable for his proportion of all the debts and liabilities of the company, contracted or incurred during the time that he was a stockholder, for the recovery of which joint or several actions may be prosecuted";[2] and under a proviso that "nothing herein contained, or hereby provided, shall, in any manner, exempt the said members from all liabilities pertaining to general partners."[3]

§ 3075. "Double Liability," when Regarded as that of Partners. — The statutory liability of stockholders to pay, in liquidation of the debts of the corporation, an amount equal to the par value of the stock held by them — often called a "*double liability*," — is in some jurisdictions regarded as that of partners, except as to the limitation of amount.[4] Under the following clause in a private statute incorporating a banking company, — "when default shall be made in the payment of any debt or liability contracted by said corporation, the stockholders shall be held individually responsible for an amount equal to the amount of stock held by them respectively," etc., — the liability thereby created has been held in effect a liability as partners,[5] but, of course, with the limitation as to the amount which each stockholder is bound to pay, and not a liability for *all* the debts, as in the case of general partners.

§ 3076. Liability as Partners Attaches to Members Who are such when Debt Contracted. — Statutes and charters

[1] Conant *v.* Van Schaick, 24 Barb. 87. That a statute declaring an *unlimited joint and several liability* creates the liability of partners, see Erickson *v.* Nesmith, 46 N. H. 371.

[2] Mokelumne Hill &c. Co. *v.* Woodbury, 14 Cal. 265; Davidson *v.* Rankin, 34 Cal. 503; Young *v.* Rosenbaum, 39 Cal. 646. See McAuley *v.* York Mining Co., 6 Cal. 80.

[3] Planters' Bank *v.* Bivingsville &c. Co., 10 Rich.L. (S. C.) 95.

[4] Coleman *v.* White, 14 Wis. 700; *s. c.* 80 Am. Dec. 797; Conklin *v.* Furman, 67 Barb. (N. Y.) 484; 8 Abb. Pr. (N. S.) (N. Y.) 161.

[5] Schalucky *v.* Field, 124 Ill. 617; *s. c.* 7 Am. St. Rep. 399. So held under analogous charter provisions, in Fuller *v.* Ledden, 87 Ill. 310; Thompson *v.* Meisser, 108 Ill. 359.

which make (or leave) the members of a corporation liable as partners for the debts of the company, without qualification, lead necessarily to several important results: 1. This liability attaches to those who were members *at the time the debt was contracted*, and not to those who had ceased at that time to be members, or who became such subsequently;[1] unless — to apply a rule which holds good in case of partnerships — the retiring members had suffered themselves to be held out as members after so retiring, and credit had been obtained by the company on the faith of their being members.[2] It is true that this rule is denied in several cases in which it might have been aptly applied,[3] as will be fully seen hereafter;[4] but a denial of it, in any case, is a denial of the ground on which it is predicated that the corporators are liable as partners.

§ 3077. Liability as Partners is that of Principal Debtors, not that of Guarantors or Sureties. — This liability is that of principal debtors, — original undertakers, — and not that of guarantors or sureties.[5] Therefore, an *extension of time* given to a corporation by a creditor will not discharge the stockholder from liability to pay the debt.[6] And the liability has been in other respects made as absolute as that of original undertakers would be, — not depending at all upon the question whether the corporate funds have been exhausted. Thus, the stockholders of a bank whose charter provided "that the

[1] Moss *v.* Oakley, 2 Hill (N. Y.), 265; Middleton Bank *v.* Magill, 5 Conn. 28, *per* Hosmer, C. J., and Brainard, J.

[2] *Post,* § 3177.

[3] Bond *v.* Appleton, 8 Mass. 472; *s. c.* 5 Am. Dec. 111; Middletown Bank *v.* Magill, 5 Conn. 28, *per curiam,* Chapman, Peters, and Bristol, JJ.; *contra,* Hosmer, C. J., and Brainard, J.; Marcy *v.* Clark, 17 Mass. 330.

[4] *Post,* § 3169, *et seq.*

[5] Harger *v.* McCullough, 2 Denio (N. Y.), 119; overruling Moss *v.* McCullough, 5 Hill (N.Y.), 131; Corning *v.* McCullough, 1 N. Y. 47; *s. c.* 49 Am. Dec. 287; Moss *v.* Averell, 10 N. Y. 449, 459; Southmayd *v.* Russ, 3 Conn. 52; Mokelumne Hill &c. Co. *v.* Woodbury, 14 Cal. 265; Davidson *v.* Rankin, 34 Cal. 503; Young *v.* Rosenbaum, 39 Cal. 646; Marcy *v.* Clark, 17 Mass. 330; Simonson *v.* Spencer, 15 Wend. (N. Y.) 548.

[6] Harger *v.* McCullough, 2 Denio (N. Y.), 119, 123. *Contra,* Hanson *v.* Dunkersley, 37 Mich. 184; Sonoma Valley Bank *v.* Hill, 59 Cal. 107; *s. c.* 9 Am. Corp. Cas. 20 (under Cal. Civ. Code, § 322).

persons and property of the stockholders shall be at all times liable, pledged, and bound for the redemption of the bills and notes of the bank at any time, issued in proportion to the number of shares that each individual may hold and possess," were held liable as principals to redeem the bills of the bank at their face, after the bills had been presented to the bank and payment refused, although the assignee of the bank had assets in his hands sufficient to pay them.[1] But under other charters and statutes the liability of the corporation must be first exhausted.[2]

§ 3078. Direct Action against the Members as Partners.— This liability, being original, and not collateral, an *action at law* lies directly against the stockholders, as against partners, on their joint contract,[3] and need not be predicated on a judgment obtained against the corporation;[4] nor is the remedy against the shareholders merged in the judgment against the company.[5]

§ 3079. Limitation Runs from Contracting of Debt. — For the same reason the statute of *limitations* begins to run in favor of the stockholder from the time when the debt was contracted.[6] But this is not so where the statute requires the

[1] Hatch *v.* Borroughs, 1 Woods (U.S.), 439.

[2] *Post,* § 3351, *et seq.*

[3] Southmayd *v.* Russ, 3 Conn. 52; Planters' Bank *v.* Bivingsville &c. Co., 10 Rich. L. (S. C.) 95; Simonson *v.* Spencer, 15 Wend. (N. Y.) 548; Freeland *v.* McCullough, 1 Denio (N. Y.), 414. One court has held that a *scire facias* on a judgment obtained against the corporation does not lie. Southmayd *v.* Russ, *supra.* The writer is unable to see the force of the reasoning by which this result is arrived at. If it proceeds upon the ground that there is no privity between the stockholders and the corporation, as Bristol, J., stated, it is undoubtedly wrong. But another court, apparently with more reason, has held that an action at law lies, *in their corporate name,* against the persons thus liable as partners. Planters' Bank *v.* Bivingsville &c. Co., 10 Rich. L. (S. C.) 95.

[4] Young *v.* Rosenbaum, 39 Cal. 646; Davidson *v.* Rankin, 34 Cal. 503; Witherhead *v.* Allen, 4 Abb. App. Dec. (N. Y.) 628.

[5] Young *v.* Rosenbaum, *supra;* Witherhead *v.* Allen, *supra;* Conklin *v.* Furman, 57 Barb. (N. Y.) 484. See Dodge *v.* Minnesota &c. Co., 16 Minn. 368.

[6] Davidson *v.* Rankin, 34 Cal. 503. The rule is the same where the officers of a corporation are made personally liable for its debts during the

creditor to exhaust his remedy against the corporation before he can sue the stockholder.[1]

§ 3080. Liability Several as Well as Joint: Assets of Deceased Stockholders Liable.—At common law the liability of partners is a *joint* liability; which means that in an action at law against partners on a partnership contract all must be joined, though the execution may be levied of the estate of any one of them; and, further, that if one partner dies, the action dies with him, and, without the aid of a statute, cannot be revived against his estate. But equity, for the purposes of justice, considers a partnership liability to be *several*, as well as joint; and hence, if one partner dies, and the other becomes insolvent, a creditor of the firm may maintain a bill in equity to have satisfaction of his debt out of the deceased partner's estate; and this rule applies to the members of corporations to whom the liability of partners attaches.[2]

§ 3081. Unlimited Several Liability without Right of Contribution. — There are probably no statutes under which a liability of this nature arises. The definition implies the case of a stockholder who is liable to pay all the debts of a corporation out of his individual estate, and is denied contribution from his co-stockholders. Stockholders were, by judicial construction, subject to this liability under the early statute of Massachusetts.[3] This construction was wholly unnecessary, and the conclusion equally destitute of support in justice and in sense. The subject will not be pursued further. There is little danger that any American court will again remand a stockholder to a position strictly resembling that of a joint tort-feasor.

§ 3082. Liability of Stockholder not Merged by Judgment against Corporation. — A constitutional or statutory liability

period of an omission on their part to perform a statutory duty. Bassett *v.* St. Alban's Hotel Co., 47 Vt. 313.

[1] *Ante*, § 2013.

[2] New England Commercial Bank *v.* Stockholders, 6 R. I. 154, 189; *s. c.* 75 Am. Dec. 688; *post*, § 3169.

[3] Stat. Mass. 1805, ch. 65; Andrews *v.* Callender, 13 Pick. (Mass.) 484; Lane *v.* Morris, 10 Ga. 162; Norris *v.* Johnson, 34 Md. 485.

imposed on the stockholders for the debts of the corporation is *not*, unless the constitutional or statutory provision clearly indicates the contrary, *a liability of the corporation and the stockholders jointly*. It must follow that a judgment against the corporation, the stockholders not having been made parties to the suit, does not prevent a subsequent action from being prosecuted against them after an execution against the corporation has been returned *nulla bona*. When, therefore, there had been a judgment against the corporation alone, and, after execution thereon returned unsatisfied, another action was brought by the judgment creditor against the corporation and three of the stockholders to recover the amount of the judgment, it was held that the action lay against the stockholders.[1] It is to be observed that there are statutes allowing actions to be prosecuted against the corporation and the stockholders jointly.[2]

[1] Dodge *v.* Minnesota &c. Co., 16 Minn. 368.

[2] See Conklin *v.* Furman, 48 N. Y. 527; affirming *s. c.* 57 Barb. (N. Y.) 484.

CHAPTER LI.

STATUTES CREATING A SEVERAL LIABILITY.

SECTION
3086. Nature and divisions.
3087. Limited several or double liability according to stock held.
3088. Further of this superadded "double liability."
3089. Individual liability for amounts withdrawn or not paid in.
3090. Liability for failure to file certificates, post notices, etc.
3091. Liability for frauds under the Iowa statute.
3092. Liability in the proportion which the members' shares bear to the corporate indebtedness.
3093. Further of these statutes.
3094. Whether solvent shareholders liable to make good defaults of insolvent ones.

SECTION
3095. Liable "to the amount of his stock," etc.
3096. Liability to amount of nominal capital.
3097. Liability "for all losses," etc.
3098. Not a liability to the corporation.
3099. Must be imposed by statute.
3100. Stockholders liable upon their own interpretation of their charter.
3101. Effect of statutory revision.
3102. Individual liability does not depend upon stock being paid for.
3103. Individual liability of married women as stockholders.
3104. Individual liability of stockholders in national banks.

§ **3086. Nature and Divisions.** — The most common liability imposed by statute upon stockholders is a *limited several* liability, each stockholder standing liable individually to creditors to a certain amount, according to the amount of stock owned by him. This liability is frequently called, on account of its several character, an *individual* liability; and in some States, where it is limited to an amount equal to the amount of stock held by the member, irrespective cf whether such stock has been paid in or not, it passes under the designation of *double* liability. This liability is generally limited in two ways: 1. To an amount equal to the shares of capital stock held by each member;[1] 2. To an amount equal to the

[1] *Ante*, § 3000.

ratio which each man's proportion of the capital stock bears to the entire corporate indebtedness.[1]

§ 3087. Limited Several or Double Liability, According to Stock Held. — Under this head, two sorts of American constitutional provisions and statutes will be found: 1. Those declaring a liability to the extent of the capital stock subscribed and not paid in.[2] These statutes are simply declaratory of the common law. 2. Those declaring a liability to the extent of the stock subscribed, *in addition* to this common-law liability. Such is the liability under a statute making each stockholder liable "to double the amount of his stock, and no more": the stockholder is liable to pay up the subscription price of the stock by him held, and also to pay, for the benefit of creditors, an equal amount again; he is not liable to pay for his stock, and twice as much more.[3] Such also is the liability under the Constitution of Minnesota,[4] which provides that each stockholder in any corporation, excepting those organized for the purpose of carrying on any kind of manufacturing or mechanical business, "shall be liable to the amount of stock held or owned by him." This does not merely make a stockholder liable to pay for his stock at its face value, but imposes a liability to the amount of stock held in addition to the liability for the stock.[5] Such also is the liability under a statute of Florida,[6] which is similar to that of Missouri.[7]

§ 3088. Further of this Superadded "Double Liability." — The distinctive characteristic of this liability is that each member stands liable for a definite sum, and no more, irrespective of the amount for which the others are liable. It is a *several*, *unequal*, and *limited* liability, as to which each member stands

[1] *Ante*, § 3001.

[2] Such is the liability under Const. Or., art. 12, § 2: Ladd *v.* Cartwright, 7 Or. 329, 333; Patterson *v.* Lynde, 106 U. S. 519.

[3] Schricker *v.* Ridings, 65 Mo. 208.

[4] Const. Minn., art 10, § 3.

[5] Willis *v.* Mabon &c. Co., 48 Minn. 140; *s. c.* 31 Am. St. Rep. 626; 50 N. W. Rep. 1110.

[6] McClellan Dig., Fla. Stat., p. 232, § 20.

[7] Gibbs *v.* Davis, 27 Fla. 531; *s. c.* 8 South. Rep. 633.

alone, except that if he pays more than his proportion of the debts of the company, he may, as in other cases, have *contribution* from his fellow-shareholders.[1] Judgment cannot be rendered against the members jointly, or against each *in solido*.[2] It necessarily follows that in those States whose policy permits a creditor to bring an *action at law* to enforce this liability, the action is *not joint*, as where the members are liable as partners,[3] but each member must be separately sued.[4] But this, as we shall see, presents no obstacle to the joining of all the members as defendants in a suit in equity; for these courts have the power, in a proceeding in which all the members are before it, to mould their decree according to the several rights and liabilities of each member.[5] The rūle in equity is, therefore, the reverse of that at law; here, all members must be made parties, unless the joinder of some is shown to be impracticable.[6] There is, however, no inflexible rule on this subject. Thus, in a creditor's suit in equity against shareholders in Kentucky, some of whom had not been served with process, it was held that, since their liability was several under the statute, to decree against some of them and continue the cause as to the others was not error;[7] but in Louisiana the court, while holding that, a judgment could not be rendered against stockholders *in solido* for a corporate debt, ruled that it was error to single out a portion of the stockholders and take judgment against them, and lay the cause over as to the rest.[8] But here the liability appears to have been that of *partners*, the charter providing that the stock-

[1] *Post*, § 3816.

[2] Reynolds *v.* Feliciana Co., 17 La. 397–406.

[3] *Post*, § 3500.

[4] Paine *v.* Stewart, 33 Conn. 516; Bank of Poughkeepsie *v.* Ibbotson, 24 Wend. (N. Y.) 473; Abbott *v.* Aspinwall, 26 Barb. (N. Y.) 202; Perry *v.* Turner, 55 Mo. 418; Pettibone *v.* McGraw, 6 Mich. 441; Re Hollister Bank of Buffalo, 27 N. Y. 393; *s. c.* 84 Am. Dec. 292; Pratt *v.* Bacon, 10 Pick. (Mass.) 123, 127; Gibbs *v.* Davis, 27 Fla. 531; *s. c.* 8 South. Rep. 633.

[5] Umsted *v.* Buskirk, 17 Ohio St. 113; Perry *v.* Turner, 55 Mo. 418, 426, *per* Napton, J.

[6] Umsted *v.* Buskirk, 17 Ohio St. 113; Pierce *v.* Milwaukee Co., 38 Wis. 253; Coleman *v.* White, 14 Wis. 700; *s. c.* 80 Am. Dec. 797; Crease *v.* Babcock, 10 Met. (Mass.) 525.

[7] Castleman *v.* Holmes, 4 J. J. Marsh. (Ky.) 1, 5.

[8] Reynolds *v.* Feliciana Co., 17 La. 397.

holders should not be exempt from personal liability for losses which might be sustained beyond the amount of the capital stock.[1]

§ 3089. **Individual Liability for Amounts Withdrawn or not Paid in.**—Statutes are found which state the common-law liability more broadly than can be extracted from some of the decisions, such as the statute of Maine, declaring that the capital stock subscribed for any corporation shall stand as a security of all its creditors, and that "no payment upon any subscription or agreement to or for the capital stock of any corporation shall be deemed a payment within the purview of this act, unless *bona fide* made in cash, or in some other matter or thing at a *bona fide* and fair valuation thereof";[2] and declaring the withdrawal of any portion of the capital stock of the corporation, directly or indirectly, to be void as against any person having thereafter a *bona fide* judgment against the corporation, and also against receivers and trustees;[3] and giving a bill in equity to creditors, trustees, or receivers of corporations against any person or persons who have subscribed for or agreed to take stock in any corporation, and have not paid for the same, or who have received dividends declared from the capital stock, or in violation of any statute, or who have withdrawn any portion of the capital stock, or canceled or surrendered any of their stock, and received any valuable consideration therefor from the corporation except its own stock or obligation for its own stock, or who have transferred any of their stock to the corporation, as collateral or otherwise, and received any valuable consideration therefor;[4] and providing that "no stockholder in any corporation in this State, except in banks, shall hereafter be liable for the debts or claims against said corporation beyond any amount or amounts withdrawn or not paid in as aforesaid; but this act shall not affect the liability of any officer of any corporation."[5] This act is held to have repealed by implication a

[1] 1 Moreau's Dig. 261.
[2] Maine act of Feb. 24, 1871, § 1.
[3] *Ibid.*, § 2.
[4] *Ibid.*, § 3.
[5] *Ibid.*, § 5.

former statute[1] of the same State, relating to the liability of stockholders in manufacturing, mining, and quarrying corporations.[2] Both branches of it, that which makes the stockholders liable in respect of their unpaid subscriptions, and that which makes them liable for dividends declared from the capital stock, or in violation of any statute, are believed to be merely declaratory of the common law.

§ 3090. Liability for Failure to File Certificates, Post Notices, etc.—There are also statutes making shareholders individually liable for the debts of the corporation in consequence of the failure of the *directors* and *managing officers* to do certain acts,—as to *file certain reports*, or to *publish certain statements* touching their organization, the amount of their stock, the terms of its payment, etc. This liability, however, is more commonly, and justly, attached to directors and officers than to stockholders at large.[3] Under such a statute, providing that corporations should publish their organization, amount of stock, conditions of payment, name, place of business, etc., and that they should post up a copy of their by-laws in their office, and providing further that a failure on the part of the company substantially to comply with these provisions should render the property of the stockholders liable for the debts of the corporation, it was held that a failure to post the by-laws was not such a failure to comply with the regulations as would render the stockholder liable for the corporate debts.[4] Analogous to this is the principle that where the stockholders in a *limited partnership* file a certificate falsely stating that the stock has been paid for, when such is not the case, they are liable as *general partners* under a similar statute.[5] But such statutes are regarded as *penal*, in the sense of principles already considered;[6] and, accordingly, it is held that if the resident stockholders are made liable under such a statute, the *non-resident* stockholders will not be compelled to

[1] Rev. Stat. Maine, ch. 48, § 9.

[2] Poor *v.* Willoughby, 64 Me. 379.

[3] *Post*, § 4221, *et seq.*

[4] McKellar *v.* Stout, 14 Iowa, 359.

[5] Hite Natural Gas Co.'s Appeal, 118 Pa. St. 436.

[6] *Ante*, § 3018, *et seq.*

make *contribution*,—the governing principle being that penal laws have no extraterritorial force.[1] But, of course, such statutes must be *substantially complied with*, in order to exonerate the stockholders; and if the statute[2] requires the filing of an annual certificate, *truly* stating the assets and liabilities, the filing of a *false* certificate will, of course, make the stockholders liable.[3]

§ 3091. Liability for Frauds under the Iowa Statute.— In Iowa there is the following statute: "Intentional fraud in failing to comply substantially with the articles of incorporation, or in deceiving the public or individuals in relation to their means or their liabilities, shall subject those guilty thereof to fine and imprisonment, or both, at the discretion of the court. Any person who has sustained injury from such fraud may also recover damages therefor against those guilty of participating in such fraud."[4] Fraud must be established to authorize the recovery of damages against members of a corporation under this statute. It does not give a right of action for *negligence* or *mismanagement*.[5] There must have been not only an *intention to deceive*, but some *act* done with such intention.[6]

[1] Sayles *v.* Brown, 40 Fed. Rep. 8. See *ante*, § 3052.

[2] Here Pub. Stat. R. I., ch. 155, §§ 11, 12.

[3] Congdon *v.* Winsor, 17 R. I. 236; Index HH, 59; 21 Atl. Rep. 540; Hite Natural Gas Co.'s Appeal, *supra*. Compare *post*, § 4125. The private property of stockholders of a corporation is not rendered liable for the debts thereof merely by a failure to comply with *Iowa* code, sections 1076–1078, as to the *book-keeping*, etc.; nor by the creation of an indebtedness exceeding two-thirds of the capital stock. Langan *v.* Iowa &c. Constr. Co., 49 Iowa, 317; *ante*, § 2869. The New York law of 1853, chapter 333, is not affected by the law of 1875, chapter 510, amending the law of 1848, chapter 40, section 12. The cash paid in and the stock for personal property transferred to the corporation must still be specified in the annual report. Pier *v.* George, 17 Hun (N. Y.), 207. Members of a co-operative association organized under the Pennsylvania act of June 7, 1887, are not rendered individually liable for its debts by its failure to publish on its letter-heads the notice in regard to credit required by section 8, nor because the association sells on credit, or in good faith confesses judgment to one of its members for an honest debt. Bendall *v.* Jackson, 11 Pa. Co. Ct. 183.

[4] Iowa code of 1873, § 1071; McClain Ann. Stat., § 1621.

[5] Hoffman *v.* Dickey, 54 Iowa, 135. Compare Donworth *v.* Coolbaugh, 5 Iowa, 300.

[6] Miller *v.* Bradish, 69 Iowa, 278.

§ 3092. Liability in the Proportion Which the Members' Shares Bear to the Corporate Indebtedness. — Some of the constitutions [1] and statutes have adopted the policy of making each stockholder of a corporation liable in the proportion which his portion of the whole share capital bears to the whole amount of the corporate debts. To illustrate: Suppose the capital stock were $100,000, and the total debts $50,000. A stockholder who owns one-tenth of all the shares of capital stock must contribute $5,000 towards paying these corporate debts, or one-half the par value of his shares, and no more. In other words, each share of stock is assessed fifty per cent. Again, suppose the capital stock to be $100,000, and the debts $200,000. A member owning one-tenth of the shares would be obliged to contribute $20,000, or twice the amount of his portion of the stock. In other words, each share of stock would be assessed two hundred per cent upon its par value.[2] The liability of stockholders under such charters and statutes differs from that of partners and members of joint-stock companies in this: that here each member can be called upon to pay only his proportion, although by reason of the insolvency of the other members some of the debts go unpaid;[3] but there a single solvent member may be obliged to pay all the debts of the firm or company, and get contribution from his copartners if they are able to respond. This scheme, while relieving stockholders of the onerous burdens of partners, has the advantage of making them interested to exert their power to prevent the extravagant contracting of corporate debts; since, whatever may be the amount of each member's stock, the greater the debts, the greater his liability. This species of liability is not, however, likely to become a favorite of legislation, because in many cases some of the stockholders will be found insolvent or beyond the reach of process, and, since the stockholders are not sureties for each other,[4] the sums contri-

[1] *Ante*, § 3001.

[2] Adkins *v.* Thornton, 19 Ga. 325.

[3] Larrabee *v.* Baldwin, 35 Cal. 155, 178.

[4] Crease *v.* Babcock, 10 Met. (Mass.) 525; Lane *v.* Harris, 16 Ga. 217, 234; Larrabee *v.* Baldwin, 35 Cal. 155. Illustrations of this liability may be seen in Wiswell *v.* Starr, 48 Me. 401; in Dane *v.* Young, 61 Me. 160; in

buted by the rest will leave a portion of the corporate debts unpaid.

§ **3093. Further of these Statutes.**—The liability thus declared has been held subject to be *reduced* by the amount of the indebtedness of the corporation which the stockholder may have taken up before the commencement of the suit against him, although the statute does not say so in terms; so that if he has redeemed bills of the bank to the amount of his personal liability, this discharges him.[1] By a palpable misconstruction of such a provision in a Georgia bank charter, the *proportionate* liability there imposed upon the stockholders was reduced to an ordinary individual liability, so that each stockholder might be sued at law by any billholder, and charged to the amount of the par value of his shares.[2] But as the corporation was allowed to contract *debts* to *three times* the amount of its capital stock, the majority conceded that each stockholder might be made liable for his share of the debts (not merely of the circulating notes) by a proceeding in equity; and this was the principle adopted by the court in construing a subsequent charter.[3] By a similar misconstruction, a statute of Massachusetts providing that the shareholders of banking corporations should be liable "*in porportion* to the amount of stock they may respectively hold at the dissolution of the charter," was made to read "*to the amount* of the stock they may respectively hold," etc.; in other words, it was reduced to an ordinary individual liability to the extent of the par value of the shares of each shareholder.[4] Under a California statute imposing this species of liability, but giving

Branch *v.* Baker, 53 Ga. 502, 512; in Lane *v.* Morris, 8 Ga. 468; in Belcher *v.* Willcox, 40 Ga. 391; in Robinson *v.* Bank of Darien, 18 Ga. 65, 109; and in Castleman *v.* Holmes, 4 J. J. Marsh. (Ky.) 1.

[1] Branch *v.* Baker, 53 Ga. 502, 512; Lane *v.* Harris, 16 Ga. 217; Belcher *v.* Willcox, 40 Ga. 391; Robinson *v.* Bank of Darien, 18 Ga. 65, 109. Compare Tallmadge *v.* Fishkill Iron Co., 4 Barb. (N. Y.) 382. This rule is frequently declared in the statutes creating this species of proportionate liability. See, for instance, Cal. Laws 1863, 736.

[2] Lane *v.* Harris, 16 Ga. 217 (Benning, J., dissenting).

[3] Branch *v.* Baker, 53 Ga. 502.

[4] Crease *v.* Babcock, 10 Met. (Mass.) 525, 557, 560.

at the same time either a joint or several action to recover the same, it was held that the recovery was not limited to the stockholder's proportion of each particular debt sued for, but that any creditor, whose debt was sufficient, might collect of any stockholder the entire amount which the latter was liable to pay as his proportion of all the corporate debts, leaving him to seek contribution from his co-stockholders; so that, when any stockholder had paid to one or more creditors his proportion of all the corporate debts, his liability ceased. In order to determine how much any one stockholder was liable to pay to the particular creditor by whom he chanced to be sued, it was necessary to find the whole amount of the indebtedness of the corporation, created while he was a stockholder; and any one creditor whose demand was large enough might have judgment against the stockholder whom he singled out for the latter's proportion of all corporate debts.[1] The enormous inconvenience of the statute is seen at a glance. It allowed any creditor to sue any stockholder at law, but yet it was necessary, in order to ascertain the measure of his recovery, that an *account* should be taken and stated of all the debts of the corporation contracted during the time when he was a stockholder.

§ 3094. Whether Solvent Shareholders Liable to Make Good Defaults of Insolvent Ones. — Statutory schemes have existed (but they are few) under which, in case the assets of a corporation are not sufficient to satisfy all its creditors, the corporators are individually liable to make good the deficiency, including that which may arise from the insolvency of any of the corporators to the extent of the capital professed to be paid in as set forth in the charter.[2] But where, in order to discharge the liabilities of an insolvent *national banking association*, the Comptroller of the Currency has assessed against the several shareholders a sufficient percentage upon the par value of the stock by them respectively held to discharge its liabilities, in case it is all collected, he has no power

[1] Larrabee *v.* Baldwin, 35 Cal. 155.

[2] Haslett *v.* Wotherspoon, 1 Strob. Eq. (S. C.) 209.

to direct a further assessment to supply the deficit caused by the inability of the receiver to enforce payment from such as are insolvent or beyond the jurisdiction, although the first assessment was for an amount less than the par value of the shares;[1] and it was so held under a statute making each shareholder liable to contribute "equally and ratably" to the amount of his shares.[2]

§ 3095. Liable "to the Amount of His Stock," etc. — Where the charter or statute expresses the liability by the words "to the amount of his stock," or "to the amount of his stock and no more," this means a *superadded liability* to the full amount of the *par value* of the shares held by each stockholder, and is not satisfied by his merely paying up what is due on his share subscription.[3]

§ 3096. Liability to Amount of Nominal Capital. — It has been held that where persons are incorporated "with a present capital of $60,000," when, in fact, the capital paid in is only $37,000, creditors of the corporation may compel the corporators to fill up the capital to $60,000, in order to satisfy their demands.[4] This is no more than requiring them to

[1] United States *v.* Knox, 102 U. S. 422.

[2] Re Hollister Bank, 27 N. Y. 393; *s. c.* 84 Am. Dec. 292.

[3] McDonnell *v.* Alabama Gold Life Ins. Co., 85 Ala. 401; *s. c.* 5 South. Rep. 120; Shricker *v.* Ridings, 65 Mo. 208; Gausen *v.* Buck, 68 Mo. 545 (overruling Lewis *v.* St. Charles County, 5 Mo. App. 225); Lewis *v.* St. Charles County (second appeal), 13 Mo. App. 48, 52; Root *v.* Sinnock, 120 Ill. 350; *s. c.* 60 Am. Rep. 558; Culver *v.* Third Nat. Bank, 64 Ill. 528; Tibballs *v.* Libby, 87 Ill. 142; Bromley *v.* Goodwin, 95 Ill. 118; Wincock *v.* Turpin, 96 Ill. 135, 141; Harper *v.* Union Man. Co., 100 Ill. 225; Eames *v.* Doris, 102 Ill. 350; Thompson *v.* Meisser, 108 Ill. 362; Queenan *v.* Palmer, 117 Ill. 619; Slee *v.* Bloom, 20 Johns. 669, 683; Briggs *v.* Penniman, 8 Cow. (N. Y.) 387, 395; *s. c.* 18 Am. Dec. 454; Bank of Poughkeepsie *v.* Ibbotson, 24 Wend. (N. Y.) 473; Re Empire City Bank, 18 N. Y. 199, 218; Lane's Appeal, 105 Pa. St. 49, 57; *s. c.* 51 Am. Rep. 166; Woodruff &c. Iron Works *v.* Chittenden, 4 Bosw. (N. Y.) 406; Pettibone *v.* McGraw, 6 Mich. 441; Walker *v.* Crain, 17 Barb. (N. Y.) 119; Ohio Life Ins. Co. *v.* Merchants' Ins. Co., 11 Humph. 1; *s. c.* 53 Am. Dec. 742. See, also, Norris *v.* Johnson, 34 Md. 485.

[4] Haslett *v.* Wotherspoon, 1 Strob. Eq. (S. C.) 209, 229.

make good the representation which they have induced the Legislature to put into their charter.

§ **3097. Liability "for All Losses," etc.** — A bank charter declaring that "the stockholders of said bank shall be personally and individually liable for all losses, deficiencies, and failures of the capital stock of said bank," has been held to make the stockholders personally liable to the creditors of the bank for its debts, in proportion to their respective shares in the stock of the same,[1] and not merely bound to keep the capital good by assessments. A bank charter making the stockholders individually liable "to make good losses to depositors and others," renders the stockholders liable to *all creditors* suffering from the failure of the bank to pay its debts.[2] But no *personal liability* is imposed on the stockholders of an insolvent corporation in process of liquidation, by a clause in the charter that "if, at any time, the capital stock paid into said corporation shall be impaired by losses or otherwise, the directors shall forthwith repair the same by assessment."[3]

§ **3098. Not a Liability to the Corporation.** — It may be stated generally — and this statement will probably apply to most of the forms of superadded individual liability which have been imposed upon stockholders by statute — that this liability is not a liability to the corporation, nor can the corporation sue to enforce it on the ground that the corporation is a trustee for its creditors.[4] While the directors of a corporation are, in some sense, in the view of American courts, trustees for the creditors of the corporation, yet the corporation itself, considered as a person, is no more a trustee for its creditors than a natural person is a trustee for his creditors. Though expressions of this kind have been dropped in judi-

[1] Atwood *v.* Rhode Island Agric. Bank, 1 R. I. 376.

[2] Queenan *v.* Palmer, 117 Ill. 619.

[3] Dewey *v.* St. Albans Trust Co., 37 Vt. 332. Construction of charter provision that stock shall not be assessed more than fifty per cent. Wilber *v.* Glen Iron Works, 18 Nat. Bank. Reg. 178.

[4] Liberty &c. College *v.* Watkins, 70 Mo. 13; Atwood *v.* Rhode Island Agric. Bank, 1 R. I. 376.

cial decisions,[1] yet they tend to confuse legal ideas. If it were suggested that a sheriff, indebted beyond his means of payment, could maintain an action against the sureties on his own bond, on the theory that he was a trustee for his creditors, the absurdity of the proposition would be at once seen. Nor could any one fail to perceive that such a rule, instead of preserving a security intended by law for creditors, would inevitably tend to destroy it; for, as was well said by the Supreme Court of Ohio, "if the corporation has the right to enforce this liability by assessments, it can exhaust it to discharge a present indebtedness, and continue its business, with no other security to its future creditors."[2]

§ **3099. Must be Imposed by Statute.** — The superadded individual liability dealt with in this chapter, being an exception to the rule of non-liability of the common law,[3] must, as a general rule, be imposed by a constitutional ordinance or a statute, or it does not exist at all.[4] It cannot, we have seen,[5] be imposed by a mere *by-law*, though, of course, it may be assumed by the stockholders by a *contract* with the creditors, provided the contract is supported by a *consideration*,[6] and is in writing.[7]

§ **3100. Stockholders Liable upon Their Own Interpretation of Their Charter.** — But if the stockholders of an intended banking company, in their application to the Legislature for a charter, declare that the private property of the stockholders is to be holden for the debts of the bank, and also publish upon the bills of the bank a statement that "stockholders' private property holden," these acts amount to *construction of the charter* by the parties themselves, which they will not be permitted afterwards to repudiate.[8]

[1] Karnes *v.* Rochester &c. R. Co., 4 Abb. Pr. (N. S.) (N. Y.) 107.

[2] Umsted *v.* Buskirk, 17 Ohio St. 114, 117; *ante*, § 342.

[3] *Ante*, § 2925.

[4] Libbey *v.* Tobey, 82 Me. 397; *s. c.* 19 Atl. Rep. 904. See Norton *v.* Hodges, 100 Mass. 241; Ossipee Man. Co. *v.* Canney, 54 N. H. 295; Shaw *v.* Boylan, 16 Ind. 384.

[5] *Ante*, § 2927.

[6] *Ante*, § 2928.

[7] *Ibid.*

[8] Atwood *v.* Rhode Island Agric. Bank, 1 R. I. 376.

§ **3101. Effect of Statutory Revision.** — The thirteenth section of the General Corporation Law of Missouri of 1845 declared that in all corporations "hereafter created," the corporators should be subject to a double liability.[1] In 1855 this law was revised, and the thirteenth section of the revised act, in precisely the same language, declared the same liability in all corporations "hereafter created."[2] The word "hereafter," when used in a statute, it was declared in the revision of 1855, should be construed to mean "the time after the statute containing such term shall take effect." By another section of the same revision it was declared that all acts revised at that session of the general assembly should be taken and construed as repealing the acts previously in force.[3] The Masonic Hall Association having been incorporated in 1853, it was held that the double liability imposed upon its stockholders by the law of 1845 was removed by the repeal of that law in 1855; that the law as then re-enacted did not apply to any corporation created before its date, and therefore the stockholders of that corporation were not subject to a double liability.[4] Norton, J., dissented on the ground that the thirteenth section of the act concerning corporations in the Revised Statutes of 1855 was a literal copy of the thirteenth section of the act concerning corporations in the Revised Statutes of 1845, and, for that reason, should not be construed as an original law taking effect only from the revision, but merely as a continuation of the law revised.[5] The conclusion of the majority is justified by the sweeping language of the repealing clause of the revision of 1855; but it can scarcely be conceived that the Legislature intended such a result. The only safe rule applicable in such a case had been laid down by the same court in previous decisions, which, however, the court held inapplicable to the repealing clause in question. "It would be of the most mischievous consequence to hold that the revision of a law had the effect

[1] Rev. Stat. 1845, p. 233.

[2] Rev. Stat. 1855, p. 372.

[3] Rev. Stat. 1855, p. 1026, § 20.

[4] Fairchild *v.* Masonic Hall Asso., 71 Mo. 526, 527.

[5] Fairchild *v.* Masonic Hall Asso., 71 Mo. 526.

of making the revised law entirely original, to be construed as though none of its provisions had effect but from the date of the revised law. When a former provision is included in a revised law, it is only thereby intended to continue its existence, not to make it operate as an original act to take effect from the date of the revised law. The revision has not the effect of breaking the continuity of those provisions which were in force before it was made."[1]

§ 3102. Individual Liability does not Depend upon Stock Being Paid for. — Of course, the individual liability of a stockholder depends upon whether he has assumed, by contract, the obligations of a stockholder; not whether he has kept his contract by paying for his shares according to his engagement; nor, as already seen,[2] upon his having received a *certificate*.[3] So the provision in an act of incorporation, that stockholders shall be individually responsible "to the extent of double the amount of the stock subscribed for or held by them," makes them liable to double the par value of their stock, whether it is paid up or not.[4]

§ 3103. Individual Liability of Married Women as Stockholders. — The capacity of married women to assume the obligations of shareholders, which has already been considered in a general way,[5] will now be considered with special reference to the superadded individual liability imposed upon shareholders by statutes. A general statute imposing an individual liability upon stockholders includes married women, unless they are specially mentioned by its terms: they are not exempted by reason of their coverture.[6] They are not exempted from the liability imposed by the act of

[1] St. Louis *v.* Foster, 52 Mo. 513, 516, 517. See, also, St. Louis *v.* Alexander, 23 Mo. 483, 509.

[2] *Ante*, § 1140.

[3] Mitchell *v.* Beckman, 64 Cal. 117.

[4] Driesbach *v.* Price, 133 Pa. St. 560; *s. c.* 19 Atl. Rep. 569.

[5] *Ante*, §§ 1096, 1097.

[6] Re Reciprocity Bank, 22 N. Y. 9. See, also, Sayles *v.* Bates, 15 R. I. 342; *s. c.* 5 Atl. Rep. 497; Driesbach *v.* Price, 133 Pa. St. 560; *s. c.* 19 Atl. Rep. 569.

Congress[1] upon shareholders in national banks;[2] and this is so, whether the shares were acquired by subscription, purchase, bequest, or otherwise.[3] It is so, even where the husband may have transferred such shares to his wife to conceal them from his creditors: if she accepts the transfer, ratifies it, or accepts benefits under it, so as to *become the owner* of the shares, she will be liable to be assessed as a shareholder,[4] and the receiver of the bank may recover a judgment against her upon the assessment; but no opinion is expressed as to what property may be reached in the enforcement of the judgment.[5]

§ 3104. Individual Liability of Stockholders in National Banks.—The National Currency Act provides: "The shareholders of every national banking association shall be held individually responsible, equally and ratably, and not one for another, for all contracts, debts, and engagements of such association, to the extent of the amount of their stock therein, at the par value thereof, in addition to the amount invested in such shares, except that shareholders of any banking association now existing under State laws, having not less than five millions of dollars of capital actually paid in, and a surplus of twenty per centum on hand, both to be determined by the Comptroller of the Currency, shall be liable only to the amount invested in their shares; and such surplus of twenty per centum shall be kept undiminished, and be in addition to the surplus provided for in this title; and if at any time there is a deficiency in such surplus of twenty per centum, such association shall not pay any dividends to its shareholders until the deficiency is made good; and in case of such deficiency the Comptroller of the Currency may compel the association to close its business and wind up its affairs under the provisions of chapter 4 of this title.[6] Persons

[1] U. S. Rev. Stats., § 5151.

[2] Keyser *v.* Hitz, 133 U. S. 138; Anderson *v.* Line, 14 Fed. Rep. 405; Witters *v.* Sowles, 32 Fed. Rep. 767; 35 Fed. Rep. 640; Hobart *v.* Johnson, 8 Fed. Rep. 493; *s. c.* 19 Blatchf. (U. S.) 359.

[3] Witters *v.* Sowles, 1 L. R. A. 64; *s. c.* 35 Fed. Rep. 640.

[4] Keyser *v.* Hitz, 133 U. S. 138.

[5] *Ibid.*

[6] U. S. Rev. Stats., § 5151.

holding stock as executors, administrators, guardians, or trustees shall not be personally subject to any liabilities as stockholders; but the estates and funds in their hands shall be liable in like manner and to the same extent as the testator, intestate, ward, or person interested in such trust funds would be if living and competent to act and hold the stock in his own name."[1] The liability thus imposed is for all such contracts, *debts*, and engagements as have been duly *contracted in the ordinary course of business*.[2] But creditors who make settlements with the president of a national bank after it has gone into liquidation, whereby the maker of certain notes is released, on which the bank is liable as guarantor, and whereby an attempt is made to continue the liability of the bank as guarantor, are not such creditors as can subject the stockholders to an individual liability.[3] The liability is *several*, and is not affected by the failure of any other shareholder to pay the amount assessed against him; so that each shareholder pays only what he would have to pay if all were solvent and able to respond.[4] It is an asset of the bank, to be resorted to in the event of insolvency as a sort of guaranty fund.[5] A stockholder who, with his assent, is assessed under another section of the statute[6] to restore the impaired capital of the bank, is not for this reason relieved from his individual liability under section 5151.[7] Where there has been a valid increase of the shares under the provisions of the statute, those original shareholders who, under the option given them, subscribe for the new shares and pay for them, become, of course, in the event of the insolvency of the bank, individually liable in respect of them.[8]

[1] U. S. Rev. Stats., § 5152.

[2] Schrader *v.* Manufacturers' Nat. Bank, 133 U. S. 67, 75.

[3] *Ibid.*

[4] United States *v.* Knox, 102 U. S. 422.

[5] Irons *v.* Manufacturers' &c. Bank, 21 Fed. Rep. 197.

[6] U. S. Rev. Stats., § 5205.

[7] Morrison *v.* Price, 23 Fed. Rep. 217; Delano *v.* Butler, 118 U. S. 634, 654; Scovill *v.* Thayer, 105 U. S. 143.

[8] The capital of a national bank was $500,000. It was voted to increase to $1,000,000. Four hundred and sixty thousand dollars were subscribed and paid in, A., the holder of thirty shares, paying $3,000, under an option given to shareholders. It was afterwards decided by the directors that

the increase should be $460,000 only, and this the Comptroller of the Currency, whose assent in such cases is essential, assented to. The capital becoming impaired, the shareholders were assessed, under U. S. Rev. Stats., § 5205, to make up the deficiency, and A. paid an assessment on sixty shares. It was held, the bank afterwards going into the hands of a receiver, that A. was liable, as the owner of sixty shares, to the assessment authorized by § 5151, above quoted. Delano *v.* Butler, 118 U. S. 634.

CHAPTER LII.

FOR WHAT DEBTS THESE STATUTES MAKE STOCKHOLDERS LIABLE.

SECTION
3110. Meaning of the word "debt" in such statutes.
3111. View that judgment for damages for tort not a "debt."
3112. The opposing view.
3113. Unliquidated damages.
3114. Other demands deemed to arise *ex contractu.*
3115. *Ultra vires* debts.
3116. Debts barred by limitation.
3117. Liability not revived or extended by renewals.
3118. Debts created by indorsement.
3119. Debts contracted after suspension.

SECTION
3120. Debts accruing from money loaned and misappropriated.
3121. Deposits in savings banks where no certificates are issued.
3122. Rent accruing on existing leases after insolvency.
3123. Mortgage debts under a statute.
3124. Debt paid by surety.
3125. Debts due to other stockholders.
3126. Debts due to officers of the corporation.
3127. When a debt is deemed to have been contracted.

§ 3110. Meaning of the Word "Debt" in such Statutes when Liberally Construed. — Illustrations of what Mr. Bishop calls the "elasticity of statutes,"[1] or perhaps, more properly speaking, of the elasticity of courts, may be found in the meaning which different courts have attached to the words "debt," or the expression "debt contracted," in statutes imposing upon stockholders a personal liability to pay the corporate debt. It may be premised that, under any rule of construction, a stockholder cannot be charged with an individual liability for debts not mentioned in the statute.[2] Nor is he liable, except for debts that might have been enforced against the company.[3] The *remedial* construction accorded by Mr. Justice Story to a former statute of Massachusetts[4]

[1] Bishop's Crim. Law, 1st. ed., ch. 6.

[2] Ossipee Hosiery Man. Co. *v.* Canney, 54 N. H. 295.

[3] Van Hook *v.* Whitlock, 7 Paige (N.Y.), 373; *s. c.* 3 Paige (N.Y.), 409.

[4] *Ante*, § 3015.

resulted in the conclusion that the word "debt" was to be taken in its broadest sense, as embracing *any just demands* whether growing out of contract or out of tort.[1]

§ 3111. View that Judgment for Damages for Tort not a "Debt." — But a strict construction of a statute making the stockholders of a corporation jointly and severally liable to pay the debts of the corporation, in consequence of a failure of the corporation to *publish an annual notice* of the corporate indebtedness[2]—the court deeming it a penal statute—has resulted in the conclusion that the words "debt" and "debts contracted," employed in the statute, did not embrace a *judgment* rendered against the corporation *for damages* for the sinking of a steamboat, through the negligence of the agents of the corporation, while upon its docks undergoing repairs.[3] This decision is in legal reason supportable only upon the ground that the liability created by the statute was a liability for a *penalty;* that statutes creating liability for penalties are to be strictly construed; and hence that the liability for a penalty ought not to be regarded as a liability for a debt, within the meaning of such a statute. A decision of the Supreme Court of Nebraska, when analyzed, is found to proceed upon the same ground. The plaintiff, having recovered a judgment against a horse railway company for damages for personal injuries sustained by her while a passenger on one of the cars, and having failed to collect the judgment from the company, brought her action against a stockholder under a statute imposing upon the corporation the duty of *publishing annually a true statement* "of the amount of all the existing debts of the corporation," and making the stockholder liable for its debts in the case of its failure so to do. The court held that the "debts" spoken of in the statute[4] were not debts springing out of the torts of the corporation.[5] The propriety of this conclusion is obvious. Not only was the statute

[1] Carver *v.* Braintree Man. Co., 2 Story (U. S.), 432, 447.

[2] Rev. Stat. Mo. 1845, p. 234, § 18.

[3] Cable *v.* McCune, 26 Mo. 371; *s. c.* 72 Am. Dec. 214.

[4] Gen. Stat., title "Corporations," §§ 136, 139.

[5] Doolittle *v.* Marsh, 11 Neb. 243.

penal in its nature,—if, indeed, that ought to influence the decision of the question at all,[1]—but the object of the statute was to protect contractual creditors,—persons giving credit to the corporation,—by requiring the corporation to make an annual disclosure to them of its financial condition. A decision of the Supreme Court of Michigan, dealing with the question under a statute of that State, is of more doubtful soundness. So much of the statute as is material was as follows: "The stockholders of every company incorporated under this act shall be jointly and severally liable, in their individual capacity, for all labor performed for such company; and shall also be liable for the debts of such company, for an amount equal to the amount of any unpaid stock in such company held by them at the time such *debt was contracted* and suit commenced thereon, to be recovered of any stockholder who is such when the debt is contracted, or any subsequent stockholder." The court, in view of the use of the words "debt contracted" in the statute, and professing to give it its natural meaning, without restricting or enlarging it, held that it did not extend so far as to include a judgment obtained by a passenger on the street railway of the corporation for a personal injury. The court admitted some force in the argument that the duty of carrying the passenger safely had been assumed by the corporation by contract, and that the plaintiff might have brought her action against the corporation either in the form of an action *ex contractu*, or of an action *ex delicto*, but regarded it, in substance and effect, as a judgment for damages founded upon a tort, which could not be regarded as a *debt contracted*, within the meaning of the statute.[2]

§ **3112. The Opposing View.**—This does not accord with the well-known conception of the common law that a judgment is a "*debt of record*," though it is to be confessed that such a technical definition of a judgment should not have much weight in the construction of a statute. Nor does it

[1] *Ante*, § 2906.

[2] Bohn *v.* Brown, 33 Mich. 257.

accord with that debated and debatable judicial theory which classifies judgments as *contracts*.[1] Nor does it accord with the broad meaning assigned by several courts to the same words, in giving a remedial construction to statutes *exempting homesteads* and personal property from execution. In such a statute the word "debt,"[2] and the words "debts contracted,"[3] have been held to embrace a *judgment* recovered in an action for *slander;* and the same expression has been held to embrace a judgment for costs in an action for a tort,[4] and also a judgment in an action for deceit; since in the latter case the plaintiff might have waived the tort and sued upon the contract.[5] Accordingly, where it is sought merely to subject *what remains unpaid* by the stockholder in respect of his shares, it is clear that any demand against the corporation, which has been reduced to a judgment, will be available as a basis of such a proceeding, without reference to the nature of the original

[1] "That a judgment is a contract, or in the nature of a contract, has been affirmed and denied with equal confidence." 1 Freem. Judgm., 3d ed., § 4, citing many opposing authorities.

[2] Dellinger *v.* Tweed, 66 N. C. 206.

[3] Conroy *v.* Sullivan, 44 Ill. 451.

[4] Lane *v.* Baker, 2 Grant Cas. (Pa.) 424; Smith *v.* Omans, 17 Wis. 395. *Contra*, Schouton *v.* Kilmer, 8 How. Pr. (N. Y.) 527; Lathrop *v.* Singer, 39 Barb. (N. Y.) 396.

[5] Warner *v.* Cammack, 37 Iowa, 642. See Thompson on Homesteads, § 380, *et seq.* In Crouch *v.* Gridley, 6 Hill (N. Y.), 250, it was held that a liability for a tort was not discharged under a bankrupt law, unless, before the filing of the petition in bankruptcy, it had become a *debt* by being converted into judgment. The court relied upon Buss *v.* Gilbert, 2 Maule & S. 70, where the question was fully considered. In Kellogg *v.* Schuyler, 2 Denio (N. Y.), 73, it was held that a cause of action *in trespass* was not affected by a discharge in bankruptcy, even though a verdict had been rendered before the presentment of the petition to be declared a bankrupt, provided that the judgment upon the verdict was not entered until afterwards. In Zimmer *v.* Schleehauf, 115 Mass. 52, it was held, construing the fourth clause of section 19 of the Bankruptcy Act of 1869, authorizing "contingent debts" and "contingent liabilities" contracted by the bankrupt to be proved against his estate by the creditor,—that in an *action of tort* to recover damages for *slander* and *malicious prosecution*, if the defendant is adjudicated a bankrupt after verdict and before judgment, the claim is not provable against his estate. The word "debts," as used in other statutes, has been construed in the following cases: Chase *v.* Ingalls, 97 Mass. 524; Lowell *v.* Street Commissioners, 106 Mass. 540; Esmond *v.* Bullard, 16 Hun (N. Y.), 65; Archer *v.* Rose, 3 Brewst. (Pa.) 264.

claim:[1] if it is merged in the judgment, it becomes a debt of record, in the language of the common law; and upon this point there will be no difference of judicial opinion. So, as already seen,[2] constitutional provisions and statutes securing to creditors dues from corporations by a superadded individual liability of their stockholders, are *remedial* in their nature, and hence embrace *judgments* against the corporation for *damages* in actions for its *torts*.[3] For instance, one who has recovered against the corporation a judgment for damages for *waste* may maintain an action in equity in the Circuit Court of the United States, the citizenship existing which gives jurisdiction, upon his judgment, against a stockholder, the latter being indebted to the corporation for a balance unpaid upon his shares in excess of the amount of the judgment.[4] Whether or not such a bill could be maintained for *unliquidated damages* for waste, the court had no doubt that the liability became an "indebtedness" within the meaning of the Constitution of Oregon, as soon as it had been reduced to judgment.[5] So, the word "dues," used in a State constitution imposing upon the stockholders of corporations a superadded individual liability, extends to *judgments* obtained under a statute giving a right of action for *damages resulting in death*.[6]

§ 3113. Unliquidated Damages.—The Supreme Judicial Court of Massachusetts concluded in one case that it did not admit of a reasonable doubt that the word "debt," in a statute making the members of a corporation liable for all its debts until its whole capital stock should be paid in and a certificate thereof filed for record, embraced unliquidated damages *growing out of the breach of a contract*.[7] Following

[1] Powell *v.* Oregonian R. Co., 13 Saw. 535; *s. c.* 2 L. R. A. 270; 36 Fed. Rep. 726.

[2] *Ante*, § 3015.

[3] Rider *v.* Fritchey, 49 Ohio St. 285; *s. c.* 15 L. R. A. 513; 34 Cent. L. J. 492; 36 Am. & Eng. Corp. Cas. 323; 27 Ohio L. J. 283; 30 N. E. Rep. 692.

[4] Powell *v.* Oregonian R. Co., 2 L. R. A. 270; *s. c.* 36 Fed. Rep. 726.

[5] *Ibid.*

[6] Rider *v.* Fritchey, *supra.*

[7] Mill Dam Foundry *v.* Hovey, 21 Pick. (Mass.) 417, 455. Compare Cable *v.* McCune, 26 Mo. 371; *s. c.* 72 Am. Dec. 214, where this case is criticised; and Child *v.* Boston &c. Iron Works, 137 Mass. 516, where it is explained and limited.

this decision, Mr. Justice Story, in a case before him in the Circuit Court of the United States, held that the word "debt" in a statute of Massachusetts embraced a demand against the corporation for *unliquidated damages for infringement of a patent.*[1] More recently the Supreme Judicial Court of Massachusetts have held that a liability for damages arising from infringement of letters-patent granted by the United States is not, before judgment is obtained against the corporation, a "debt" or a "contract," within the meaning of a later statute of that State[2] making the officers of a corporation liable for its debts and contracts in certain cases. The court reached this result after a comparison of many statutes of that State and of the United States, and concluded that a liability for the infringement of a patent is a liability for a *tort*, and that a liability for wrongs done which are independent of contracts cannot be considered a debt or contract within the meaning of the statute. Referring to the words of the statute, Mr. Justice Field said: "The word 'debts' and the words 'debts and contracts' do not, in their legal sense, ordinarily include liabilities for torts not reduced to a judgment. There is nothing in the statutes indicating that, for the causes stated, the officers were to be made responsible for all the liabilities of the corporation."[3] In another part of the opinion, referring to the decision of Mr. Justice Story in the case above cited,[4] the learned justice says: "There are no cases decided by the courts of the Commonwealth in which the stockholder has been held liable for a tort of the corporation, and the decision of Mr. Justice Story stands unsupported by any direct authority either before or since."[5] But where a statute provided that the stockholders and officers of corporations should be personally liable for *debts* and *civil liabilities* of such corporations in the following cases, ... "they shall be jointly and sev-

[1] Carver *v.* Braintree Man. Co., 2 Story (U. S.),432, 437. Compare Child *v.* Boston &c. Iron Works, 137 Mass. 516, 520; *s. c.* 50 Am. Rep. 328, where the doctrine of this case is denied.

[2] Mass. Stat. of 1870, ch. 224, § 38.

[3] Child *v.* Boston &c. Iron Works, 137 Mass. 516, 519; *s. c.* 50 Am. Rep. 328.

[4] Carver *v.* Braintree Man. Co., *supra.*

[5] *Ibid.*, 520.

erally liable for all *debts* and *contracts* of such corporations," etc.; and the statute, in several other places, employed the words "*debts*" and "*liabilities*,"—it was held that it could not be restricted to claims which had been liquidated or adjusted.[1] So, where a charter provided that the stockholders of the said corporation shall be holden jointly and severally, to the nominal amount of their stock, for the payment of all *debts* contracted by the said corporation, or by their agents; and any person or persons having any *demands* against the said corporation may sue any stockholder or stockholders, in any court having cognizance thereof, and recover the same, with costs; provided that no stockholder shall be obliged to pay more, in the whole, than the amount of stock he may hold in the said company at the time the *debt accrued*,—it was held that an action could not be maintained against the stockholders of the corporation for *damages* caused by suffering one of its bridges to get out of repair.[2] Of course, the stockholders of a corporation are not primarily liable for the frauds and torts of its officers and promoters, unless there is a statute making them so, or unless they themselves are such officers or promoters.[3]

§ 3114. Other Demands Deemed to Arise ex Contractu.— A statute making the *directors* of corporations liable for the debts of the corporation for declaring *dividends* while the corporation is insolvent,[4] makes them liable only for debts arising *ex contractu;* and although the debt has been reduced to judgment against the corporation, the bill seeking to charge the directors must so allege.[5] The liability of a corporation for a breach of an *implied warranty* of title in the sale of chattels is, however, a "debt" within the meaning of a statute providing that "if any company formed under this act dissolve, leaving debts unpaid, suits may be brought against any person or persons who were stockholders at the

[1] Haynes *v.* Brown, 36 N. H. 545, 565.

[2] Heacock *v.* Sherman, 14 Wend. (N. Y.) 58; *ante*, § 2925.

[3] Matthewes *v.* Stanford, 17 Ga. 543.

[4] Rev. Stat. Mo. 1845, p. 234, § 18.

[5] Cable *v.* McCune, 26 Mo. 371; *s. c.* 72 Am. Dec. 214.

time of such dissolution, without joining the company in such suit." Such a liability was held to arise wholly *ex contractu*, and, giving the statute a strict construction, which would exclude a broad popular meaning of the word "debt," the court had no difficulty in reaching this conclusion.[1]

§ **3115. Ultra Vires Debts.** — The general rule is, that the stockholders can only be made liable in respect of such debts as might have been enforced against the corporation.[2] Thus, it has been held that the shareholders at large of an English joint-stock company are not liable in respect of the bonds of the company, unauthorized, and not issued in pursuance of a general meeting, although in the hands of a *bona fide* purchaser for value, without notice of their infirmity.[3] So, a *writing, signed by the president of a corporation*, which states that a person named in it is a creditor for a certain sum, for work performed for the corporation, does not constitute a cause of action against the individuals forming the corporation, nor against the corporation, but is at most an instrument of evidence.[4] So, where elements of estoppel do not supervene, it is a simple proposition of law, and one which is declared and enforced constantly in other cases of agency, that the members of a corporation are not liable, as individuals or partners, for goods bought in its name, by an *ultra vires* act of its directors;[5] though an exception to this rule has been admitted where the associates enter upon a business entirely distinct from the business which the corporation was authorized to carry on, and in the course of that business contract debts.[6] But[7] circumstances may arise which will *estop* the stockholder from setting up this defense.[8] Thus, it

[1] Dryden *v.* Kellogg, 2 Mo. App. 87, 93.

[2] Van Hook *v.* Whitlock, 7 Paige (N.Y.), 373; Buffington *v.* Bardon, 80 Wis. 635; *s. c.* 50 N. W. Rep. 776. Compare *ante*, § 2828, *et seq.*

[3] Atheneum &c. Soc. *v.* Pooley, 31 L. T. 70; *s. c.* 4 Jur. (N. S.) 371.

[4] Curtiss *v.* Murry, 26 Cal. 663.

[5] Smucker *v.* Duncan (Pa. C. P.), 10 Pa. Co. Ct. 430.

[6] *Ante*, § 2939.

[7] *Post*, ch. 112, and ch. 130, art. 2.

[8] Amerman *v.* Wiles, 24 N. J. Eq. 13; Third Ave. Sav. Bank *v.* Dimock, *Id.* 26.

has been said, with respect to an incorporated literary society, that the original stockholders, acting within the scope of the granted powers, are not to be made liable for the acts of those who go beyond them; but the charter can furnish no protection from private responsibility to those who embark in, or *assent* to, such unauthorized acts.[1] Moreover, it has been held that where the entire business carried on by persons in the name of a corporation is such as the corporation is prohibited by law from doing, they cannot interpose the corporate privileges between them and the liabilities which the law imposes upon individuals in the transaction of similar business, without the use of the corporate name.[2] But it necessarily remains that unless, ignoring the existence of the corporation, the creditor proceeds against the stockholders as original undertakers, to enforce *their own contract*, and the circumstances exist which allow him to do this, he must show a contract which either has been enforced, or which is enforceable to judgment against the corporation. For instance, if the contract was by *promoters*, or by other persons professing to act in behalf of the corporation, before its organization, and the corporation, after coming into existence, has not *ratified* or *adopted* it, then, under principles already considered, it will not be enforceable against the corporation,[3] and consequently not against its stockholders, as such.[4]

§ **3116. Debts Barred by Limitation.** — Stockholders are not liable, under such statutes, for debts of the corporation which are barred by limitation.[5] And it has been held that this is so where the debt was so barred at the time of the dissolution of the corporation, although it could not have been enforced against the stockholders by action prior to the dissolution.[6]

§ **3117. Liability not Revived or Extended by Renewals.** It has been held that the statutory liability of stockholders is

[1] Kearny *v.* Buttles, 1 Ohio St. 362.

[2] Medill *v.* Collier, 16 Ohio St. 599.

[3] *Ante*, § 480, *et seq.*

[4] Buffington *v.* Bardon, 80 Wis. 635; *s. c.* 50 N. W. Rep. 776.

[5] Van Hook *v.* Whitlock, 3 Paige (N. Y.), 409; Cook *v.* Wheeler, Harr. (Mich.) 443.

[6] Van Hook *v.* Whitlock, *supra.*

so far like that of sureties that it cannot be revived or extended by any agreement between the creditor and the corporation renewing or extending the original debt.[1] It has been so held, construing the following statutes in New York: "All the stockholders of every company incorporated under this act shall be severally individually liable to the creditors of the company in which they are stockholders, to an amount equal to the amount of stock held by them respectively, for all debts and contracts made by such company, until the whole amount of capital stock fixed and limited by such company shall have been paid in, and a certificate thereof shall have been made and recorded as prescribed in the following [eleventh] section."[2] "No stockholder shall be personally liable for the payment of any debt contracted by any company formed under this act, which is not to be paid within one year from the time the debt is contracted, nor unless a suit for the collection of such debt shall be brought against such company within one year after the debt shall become due; and no suit shall be brought against any stockholder . . . . until an execution against the company shall have been returned unsatisfied in whole or in part."[3] Construing this statute, it is held that the year within which the action must be begun for the recovery of a debt owing by a manufacturing corporation, so as to lay a foundation for a recovery against the stockholder, begins to run on the day when the debt *first became due;* and that if the time of its payment is extended by a promissory note, which is sued within a year from the date of its maturity, but more than a year after the date when the debt for which it was given first became due, and a judgment is recovered and an execution returned unsatisfied, the stockholders cannot be charged with the payment of the debt.[4] This rule has been applied in California, follow-

[1] Hyman *v.* Coleman, 82 Cal. 650; *s. c.* 16 Am. St. Rep. 178; 23 Pac. Rep. 62; Hardman *v.* Sage, 124 N. Y. 25; *s. c.* 26 N. E. Rep. 354.

[2] New York Laws of 1848, ch. 40, § 10; 2 Birdseye Stat. N. Y., p. 1893, § 95.

[3] *Ibid.*, § 24; *Ibid.*, § 103.

[4] Hardman *v.* Sage, 124 N. Y. 25, 35; *s. c.* 26 N. E. Rep. 354; Parrott *v.* Colby, 71 N. Y. 597; affirming *s. c.* 6 Hun (N. Y.), 55; Jagger Iron Co. *v.* Walker, 76 N. Y. 521; Parrott *v.* Sawyer, 87 N. Y. 622; affirming *s. c.* 22 Hun (N. Y.), 611.

ing the New York decisions, although in California it is the settled interpretation of their statute that each stockholder of a corporation is liable for his proportion of the corporate debts contracted while he was a stockholder, *as a principal debtor*, and not as a *surety*.[1] These decisions are rendered in face of the admitted rule of law that the renewal does not extinguish the old debt and create a new one, and in the face of a statute providing that, to enforce the personal liability of stockholders, the action must be brought within three years after the cause of action accrues. But when does a cause of action accrue so long as the debt is kept alive by renewals? These decisions seem to rest upon elemental nonsense, and to result in gross injustice. One may, at least, venture to criticise a rule of interpretation which enables the officers of a corporation, by procuring its creditor to grant an extension of his debt, to succeed *in extending the debt out of existence*, and escaping the personal liability under which they rest under a statute.[2]

§ 3118. Debts Created by Indorsement. — Under a statute of New York making (or leaving) the stockholders of corporations liable *as partners*, an indorsee of negotiable paper issued by a corporation may maintain an action thereon in his own name against one who was a stockholder when the note was issued.[3] And where an indorsee of a bill of exchange drawn by a corporation, the stockholders of which were liable for its debts, had recovered judgment against the drawer, an indorser who was liable on the bill might pay it, and take an assignment of the judgment, and maintain an action against a stockholder, in the name of the plaintiff in the judgment, to recover the amount.[4]

§ 3119. Debts Contracted after Suspension. — After a corporation has gone into liquidation, the power of its officers or

[1] Hyman *v.* Coleman, 82 Cal. 650; *s. c.* 16 Am. St. Rep. 178; 23 Pac. Rep. 62.

[2] *Post*, § 4227.

[3] Freeland *v.* McCullough, 1 Denio (N. Y.), 414.

[4] Harger *v.* McCullough, 2 Denio (N. Y.), 119.

contracting agents to bind its stockholders by the creation of new obligations ceases.[1]

§ 3120. Debts Accruing from Money Loaned and Misappropriated. — Where the directors of a corporation, acting in good faith, upon the reports and representations of the duly authorized agents of the corporation, believing them to be correct, borrow money for the purposes of the corporation, it is not necessary to show that the money so borrowed was all actually appropriated to the legitimate uses of the corporation, in order to establish an indebtedness against it, or a personal liability of its stockholders in favor of the lender of the money or of the sureties who pay the loan.[2] This is in conformity with the general rule that one who pays money to a trustee is not bound to look to its application. It is sufficient, in the absence of fraud, for him to know that the trustee has power to act in the premises.[3]

§ 3121. Deposits in Savings Banks where no Certificates are Issued. — Where the charter of a banking corporation provides that its officers, when required by any person making a deposit in its savings department, shall issue certificates for the same, and makes the stockholders personally liable to depositors, it is not essential to the liability of the stockholders that a certificate be given, as the character of the deposit may be shown by a *pass-book* given to the depositor.[4]

§ 3122. Rent Accruing on Existing Leases after Insolvency. — There is some difficulty in saying under what circumstances an individual liability may be enforced against the stockholders, founded on rent accruing after the insol-

[1] Richmond *v.* Irons, 121 U. S. 27, 60; Union Bank *v.* Wando Mining &c. Co., 17 S. C. 339; Schrader *v.* Manufacturers' Nat. Bank, 133 U. S. 67. "The business of the bank must stop when insolvency is declared." White *v.* Knox, 111 U. S. 784, 787.

[2] Borland *v.* Haven, 37 Fed. Rep. 394.

[3] Mason *v.* Bank of Commerce, 16 Mo. App. 279; Goodwin *v.* American Nat. Bank, 48 Conn. 550, 564; Shaw *v.* Spencer, 100 Mass. 382, 391; *s. c.* 1 Am. Rep. 115; *s. c.* 97 Am. Dec. 107; Ashton *v.* Atlantic Bank, 3 Allen (Mass.), 217; Fountain *v.* Anderson, 33 Ga. 372. See *post*, Ch. 130.

[4] Dows *v.* Naper, 91 Ill. 44.

vency of the corporation, under a lease made before.[1] Such an indebtedness is not strictly *debitum in præsenti, solvendum in futuro;* but it is rather analogous to the case of wages to be earned under a contract of service, which may or may not be terminated before the wages are earned. It is money agreed to be paid for the future enjoyment of real property, which enjoyment may be prevented by act of the landlord himself, by an eviction, or by doing that which in law is tantamount to an eviction. But after the rents are earned, although after insolvency, there seems no difficulty in the way of holding that they become a debt of the corporation, such as can be enforced against its stockholders, — though this may, in particular cases, be influenced by the provisions of statutes.[2] The rule in England seems to be stronger in favor of the landlord than that above stated. Sir Nathaniel Lindley states it thus, citing the authorities in the margin: "Where the company is lessee for an unexpired term of years, the lessor is entitled to have a claim entered for the full amount of the rent which will become due under the lease; and he is further entitled to prevent the company from being dissolved without notice to him. But where the lease has been assigned, the lessor is not entitled to receive more from the company than it may ultimately become liable to pay under the covenants contained in the lease.[3] And the lessor is not entitled to a dividend on his claim until something becomes payable to him; nor is he entitled, as against the other creditors, to stay a dividend, nor to have any sum impounded to meet future possible demands.[4] He must trust to his power of

[1] This subject is discussed in another relation in the title on *receivers.* See ch. 160, as to "granting leave to distrain for rent"; and ch. 164, as to receiver's "obligation to pay rent."

[2] Rent due from a corporation of limited liability, organized under New York Laws 1875, ch. 611, p. 755, payable within two years from date of executing the lease and delivering the premises, has been held recoverable under §§ 25, 37; but rent accruing beyond that time was not a liability that could be enforced against the individual stockholders. McIntyre *v.* Strong, 63 How. Pr. (N. Y.) 43.

[3] See Re Haytor Granite Co., L. R. 1 Ch. 77; reversing 1 Eq. 11. And see next two notes.

[4] Re Westbourne Grove Drapery Co., 5 Ch. Div. 248; Re Horsey's Claim, L. R. 5 Eq. 561; Ex parte Elphinstone, L. R. 10 Eq. 412. As to the proof and discharge of such

distress and entry, and to his rights against the assignee if the lease is assigned. But where a company seeks to reduce its capital, it must make provision for meeting the lessor's future demands;[1] and the shareholders are not entitled to divide the assets amongst themselves without making similar provision.[2] The same rule applies to the voluntary winding up of a solvent company."[3]

claims in bankruptcy, see Hardy *v.* Fothergill, 13 App. Cas. 351.

[1] Re Telegraph Construction Co., L. R. 10 Eq. 384.

[2] Oppenheimer *v.* British & Foreign Exchange &c. Bank, 6 Ch. Div. 744.

[3] Elphinstone *v.* Monkland Iron Co., 11 App. Cas. 332; Gooch *v.* London Banking Asso., 32 Ch. Div. 41; Lind. Comp., 5th ed., 731. In another place, the same writer, treating of the winding up of companies by the court, says: "If the landlord is the legal creditor of the company in respect of the rent, which he wishes to recover by a distress upon the company's goods, he must, in order to obtain leave to distrain under section 87, show either that it is inequitable for the company to insist on section 163, or that the rent ought to be paid in full as one of the expenses of the winding up. Re Oak Pits Colliery Co., 21 Ch. Div. 322, 330; Re Lancashire Cotton Spinning Co., 35 Ch. Div. 656. A mortgagee who has a power of distress under an attornment clause is in a less favorable position for obtaining leave to distrain than an ordinary landlord. *Ibid.* In applying these principles to any given case, it is important to ascertain whether the rent for which the landlord seeks to distrain accrued due before or after the commencement of the winding up. If the rent accrued due before the commencement of the winding up, the landlord will not be allowed to distrain. Re Traders' North Staffordshire Carrying Co., L. R. 19 Eq. 60, where the distress was for tolls in arrear; Re Coal Consumers' Asso., 4 Ch. Div. 625, where the liquidator retained possession, but not for any purpose of liquidation; Thomas *v.* Patent Lionite Co., 17 Ch. Div. 250, where distress was levied after a resolution for a voluntary winding up had been passed, but before the order for a compulsory winding up, which superseded the voluntary winding up, had been made; even though the liquidator may have retained possession of, and carried on, the company's works upon the land. Re North Yorkshire Iron Co., 7 Ch. Div. 661; Re Brown, Bayley, and Dixon, 18 Ch. Div. 649, case of a mortgagee with power of distress; Re South Kensington Co-operative Stores, 17 Ch. Div. 161; Re Oak Pits Colliery Co., 21 Ch. Div. 322. The landlord must prove for his debt like any other creditor. *Ibid.* If the rent accrued since the commencement of the winding up, the landlord will be allowed to distrain for it, or receive payment in full, if the liquidator has retained possession of the property for the purposes of the winding up, or for carrying on the company's business, or in order to sell it, or do the best he can with it; for, under these circumstances, the rent is considered as one of the expenses of the winding up, and should be paid in full, like any other debt properly incurred by the liquidator. Re Lundy

§ 3123. "Mortgage Debts" under a Statute. — A statute of Maine, relating to the personal liability of stockholders, provides that they shall not be personally liable to contribute to the payment of a mortgage debt of the corporation. It was held that where the creditor had sold real estate to the corporation upon which there was a subsisting mortgage which the creditor had given to secure his note, and as a part payment of the consideration of the conveyance to it, the corporation had agreed to pay the note secured by the mortgage, and to hold the creditor indemnified against the same, — this was not a mortgage debt of the corporation within the meaning of the statute, but was a debt of the corporation such as the creditor could enforce against the stockholders. The court, speaking through Peters, C. J., said: "Their liability is upon a contract with the complainants to pay that debt. The corporation owed the complainants a sum of money equal to that debt, and agreed to pay them by paying such debt. Paying the debt would pay the complainants. Not paying it, the corporation owed the complainants the amount. The policy of the statute is only to exempt stockholders in a corporation from liability on a debt which the corporation itself has secured by mortgage, the presumption being that in such case the creditor has security enough, — at all events, security he is satisfied with."[1]

§ 3124. Debt Paid by Surety.—The liability of a principal to *indemnify his surety* for any payment the latter may be

Granite Co., L. R. 6 Ch. 462; Re North Yorkshire Iron Co., 7 Ch. Div. 661; Re Silkstone and Dodworth Iron Co., 17 Ch. Div. 158; Re South Kensington Co-operative Stores, 17 Ch. Div. 161; Re Brown, Bayley, and Dixon, 18 Ch. Div. 649; Re Oak Pits Colliery Co., 21 Ch. Div. 322. But if the liquidator has retained possession by arrangement with the landlord for his benefit as well as for that of the company, or has done nothing, but has merely abstained from trying to get rid of the property, and has not agreed to pay rent, the landlord will not be allowed to distrain, but must prove for the rent in the winding up. Re Progress Assur. Co., L. R. 9 Eq. 370; Re Bridgewater Engineering Co., 12 Ch. Div. 181; Re Oak Pits Colliery Co., 21 Ch. Div. 322. If the rent has accrued due, partly before and partly after the commencement of the winding up, and the landlord establishes his right to distrain, or be paid in full, for the latter portion of the rent, the rent will be apportioned, and the distress will be allowed for so much as accrued after the winding up commenced. Re South Kensington Co-operative Stores, 17 Ch. Div. 161." Lind. Comp., 5th ed., 680, 681.

[1] Barron *v.* Paine, 83 Me. 312, 323; *s. c.* 22 Atl. Rep. 218.

compelled to make for the former, takes effect from the time when the surety becomes responsible for the debt of his principal; so that, upon payment by the surety, the debt which the principal owes to him becomes a "debt contracted" at the time when the surety became responsible, and not at the time of such payment.[1] Applying this rule in a case where a person had accepted, for the accommodation of a corporation, drafts payable in five and six months, which drafts he was afterwards obliged to pay, it was held that the debt thereby accruing to the acceptor from the corporation was a debt contracted at the time when the drafts were accepted, within the meaning of a statute,[2] which provided that officers of corporations who neglected to file the certificate prescribed by another provision of statute,[3] should be jointly and severally liable for all debts of the corporation contracted during the continuance of such violation, refusal, or neglect.[4]

§ **3125. Debts Due to Other Stockholders.**—It has been seen that, in theory of law, a corporation is one person and each of its stockholders another person,[5] and that they are at full liberty to contract and deal with each other at arms-length, except in the case of those stockholders who are directors or other officers, whose freedom of contracting is somewhat restrained by limitations growing out of their trust relation.[6] Generally speaking, the mere fact that the creditor is also a stockholder will not deprive him of the ordinary remedies to secure his debt which the principles of equity or the statute law accord to other stockholders;[7] and in this respect there is no difference between cases where the liability which he seeks to enforce is a contractual liability for unpaid stock, or a statutory superadded liability, provided both are worked out through a general proceeding in equity, which secures ratable contribution and equality among the shareholders.

[1] Rice *v.* Southgate, 16 Gray (Mass.), 142; Cox *v.* Gould, 4 Blatchf. (U. S.) 342.

[2] Stat. Mass. 1863, ch. 246, § 2.

[3] Stat. Mass. 1862, ch. 210.

[4] Byers *v.* Franklin Coal Co., 106 Mass. 131.

[5] *Ante*, § 1071, *et seq.*

[6] *Ante*, § 1079.

[7] *Post*, § 3446, *et seq.* Compare *post*, § 4186.

When, therefore, by the governing statute of a trust company, each stockholder of the company was made individually liable to depositors and creditors to the amount of the stock subscribed for or held by him, the holders of stock paid in full, who were creditors or depositors, were entitled to participate ratably with other creditors; since the personal liability created by the statute was not in the nature of a direct indebtedness to the corporation or its creditors, but rather a collateral liability, which might or might not accrue on the final disposition of the assets of the company.[1] But this cannot be true where the liability is denounced by the statute in consequence of any *misprisions* in the management of the corporation in which the creditor stockholder himself participated; for it would be intolerable that the misdemeaning stockholder should be allowed to recover from his innocent associates the penalty of his own wrong.[2] Numerous examples of this are given in a future title.[3] Another is found in a holding that the provision of a statute of New Hampshire, that no director, officer, or stockholder who consented that the corporation should *contract debts exceeding the statutory limit* "shall recover against any stockholder who did not advise or consent thereto," applies to a stockholder to whom the corporation became indebted in excess of such limit by virtue of a contract made by him with the corporation directly.[4] Another good illustration of the foregoing statement, both in relation to *stockholders* merely and to those who have been *officers*, is afforded by a case where a bank became insolvent, and made an assignment for the benefit of its creditors. The charter made stockholders personally liable for an amount equal to the capital stock. *After the assignment,* the vice-president and a director, both stockholders, bought up claims of depositors at a discount of fifty per cent, with a fund raised from contributions of stockholders, and contended that they were entitled to a

[1] Appeal of Schlaudecker (Pa. St.), 21 Am. & Eng. Corp. Cas. 612; *s. c.* 14 Atl. Rep. 229.

[2] *Post,* § 3450.

[3] *Post,* § 4186.

[4] Connecticut River Sav. Bank *v.* Fiske, 62 N. H. 178. Nor can he have *subrogation* under a statute. Hill *v.* Frazier, 22 Pa. St. 320.

pro rata distribution, based upon the face value of these claims. This contention was objected to, on the grounds, (1) that at the time of the purchase of the claims, the purchasers were officers of the bank; (2) that the stockholders owning the claims so purchased could not participate in the distribution until all of the depositors should be paid. It was held that neither objection was tenable. The official and trust relation had been dissolved by the assignment, and there was nothing in the relation of mere stockholders which restrained their freedom in this regard.[1] It is otherwise where the confidential relation, *e. g.*, that of *treasurer*, still subsists, in which case the purchase of the debts by him will extinguish them as against the corporation,[2] or, at most, prevent him from proving them for more than his disbursements.[3]

§ 3126. Debts Due to Officers of the Corporation. — It has been held that a statute[4] making the stockholders of corporations liable to the creditors until the whole amount of the capital stock has been paid in and a certificate thereof filed, does not include the *directors* of a corporation, and that a director to whom a corporation has become indebted cannot enforce the liability so imposed. The rule is held to apply to one named as a trustee in the certificate of incorporation, and who acts as such, although he is not a stockholder; since he may be a director, at least *de facto*, without being the owner of any shares. The court reason that the word "debts" in a provision of the Constitution of New York,[5] providing that "debts due from corporations shall be secured by such individual liability of the corporators . . . . as may be prescribed by law," does not include debts due to the directors of the corporation.[6]

§ 3127. When a Debt is Deemed to have been "Contracted." — The latitude embraced between a *strict* and a *liberal*

[1] Craig's Appeal, 92 Pa. St. 396.

[2] Hill *v.* Frazier, 22 Pa. St. 320.

[3] *Post*, §§ 4040, 4041.

[4] The New York "General Manufacturing Act," Laws N. Y. 1848, ch. 40, § 10.

[5] Const. N. Y., art. 8, § 2.

[6] McDowall *v.* Sheehan, 129 N. Y. 200; *s. c.* 29 N. E. Rep. 299; 41 N. Y. St. Rep. 415.

construction of such a statute is also illustrated by the construction which was put upon a statute of New York, by which corporations were required to make, publish, and file a report of their condition within twenty days after January first in each year, in default of which all the trustees of the company were declared to be jointly and severally liable for all the debts of the company then existing, and for all that should be contracted before such report should be made.[1] A corporation failed to make its annual report in January, 1850, and did not comply with this requirement of the statute until the time for making its next annual report came around. In December, 1850, while the corporation was thus in default, the plaintiff contracted to deliver to it certain lumber, taking its notes at ninety days. The lumber does not appear to have been delivered while the company was thus in default, and it was not in default at the time when the note sued on was given. The court, proceeding on the view that the statute was highly *penal*, and demanded a strict construction, held that there was no "debt" in existence until the lumber was delivered.[2]

[1] Acts N. Y. 1848, ch. 40, § 12.

[2] Garrison *v.* Howe, 17 N. Y. 458, 464, 466.

CHAPTER LIII.

LIABILITY FOR INTEREST, FEES, AND COSTS.

SECTION
3132. Stockholder liable for interest, though not in excess of his statutory liability.
3133. Liability for interest from date of suit, although in excess of statutory liability.
3134. View that interest is not recoverable of the stockholder.
3135. Counsel fees.
3136. From what date interest runs against stockholder.
3137. Stockholder liable for costs of proceeding against him.
3138. Liability to costs where proceeding is in equity.

§ 3132. Stockholder Liable for Interest, though not in Excess of His Statutory Liability. — The question whether *interest* will be allowed in a proceeding to charge a stockholder does not rest on precisely the same principles as the question of costs.[1] Of course, if the principal of the judgment, together with the interest, does not exhaust the sum for which the stockholder is liable, then the judgment will carry interest as in other cases, and the stockholder will be liable for interest as well as for the principal.[2]

§ 3133. Liability for Interest from Date of Suit, although in Excess of Statutory Liability. — But if the creditor is kept out of his money through the refusal of the stockholder to pay when demand is made upon him, he ought to receive interest during the time he has been thus wrongfully delayed, although such interest, together with the principal, make a sum in excess of the amount for which the stockholder otherwise would have been liable. Upon this principle, it has been ruled that interest will run against the

[1] *Post*, § 3137.

[2] Grund *v.* Tucker, 5 Kan. 70, 79; Richmond *v.* Irons, 121 U. S. 27; Haslett *v.* Wotherspoon, 1 Strobh. Eq. (S. C.) 209.

stockholder from the date of the commencement of the suit against him, although it results in charging him with a sum in excess of that for which he was individually liable.[1]

§ 3134. View that Interest is not Recoverable of the Stockholder. — Several of the courts have denied the principle that interest is recoverable of the stockholder,[2] proceeding chiefly on the ground that the liability is to be sought in the statute alone, and that it is to be strictly construed. If the statute makes the stockholders liable to the creditors, each for his *proportion* of the corporate debts, then interest will not be allowed, because no stockholder can tell how much he is to pay, or to whom, until it is ascertained by a general suit in equity. Not being able, therefore, to pay, or tender payment, he cannot be treated as being in default.[3]

§ 3135. Counsel Fees. — One court has held that in a suit in equity, the court has power to allow to the plaintiffs reasonable counsel fees, payable out of the fund;[4] but another court has held that the fees of the plaintiff's solicitors should not be charged to the fund obtained from the stockholders.[5]

[1] Burr *v.* Wilcox, 22 N. Y. 551; Mason *v.* Alexander, 44 Ohio St. 318; Wehrman *v.* Reakirt, 1 Cin. Sup. (Ohio) 230, 239. Upon like grounds, it has been held that, *after default* of a *surety* in a bond for the payment of money, the debt carries interest against the surety, although it results in a judgment against him greater than the penalty of the bond. Fraser *v.* Little, 13 Mich. 195; *s. c.* 87 Am. Dec. 741; Brainard *v.* Jones, 18 N. Y. 35. This, however, may not be the prevailing rule. See Sedgw. on Dam. 425.

[2] Munger *v.* Jacobson, 99 Ill. 349; Cole *v.* Butler, 43 Me. 401, 405; Sackett's Harbor Bank *v.* Blake, 3 Rich. Eq. (S. C.) 225, 233.

[3] Crease *v.* Babcock, 10 Met. (Mass.) 525, 568; Grew *v.* Breed, 10 Met. (Mass.) 569, 577. This rule would probably not hold good under the construction placed upon similar statutes in Georgia, allowing several *actions at law* by any creditor against any stockholder, and sanctioning *voluntary payments* by the latter. *Post*, § 3604. For a construction of the deed of settlement of an English joint-stock company, under which it was held that a shareholder was bound to pay a call, in consequence of which his shares had been forfeited, but not interest on them, see Stocken's Case, L. R. 3 Ch. 412.

[4] Mason *v.* Alexander, 44 Ohio St. 318; *s. c.* 7 N. E. Rep. 435; 4 West. Rep. 450.

[5] Alling *v.* Wenzell, 27 Ill. App. 511.

§ 3136. From What Date Interest Runs against Stockholder. — Where interest is allowable, which, as already seen, may be to the extent of the stockholder's liability under some theories, or in *excess* of it under others, it often becomes a question from what date it is to be computed. If his liability to pay is not restricted to the amount of his general liability, then it is clear that the interest runs from the maturity of the *debt*, from the date of the *demand*, or from the date of the bringing of the *suit*, just as it would run in an ordinary case under the provision of the statute relating to interest. In such cases it has been held to run from the maturity of the *debt;*[1] in a winding-up proceeding, from the date of the *final call* and notice thereof to the stockholders;[2] in a case of liability to *redeem* the bills of a bank, from the time when the *redemption* was *demanded* by the billholders of the stockholder, and not from the time when payment was demanded of the bank;[3] under the New York Manufacturing Act,[4] from the time when suit is begun against the stockholder;[5] in the liquidation of a *national bank*, from the date of the *suspension;* and in case of book accounts in favor of depositors, *interest* runs from such date, without any demand;[6] and under statutes of Wisconsin, from the date of the *judgment* by which it is ascertained that the assets of the bank have been exhausted, and that the deficiency exceeds the amount of the stock.[7]

§ 3137. Stockholder Liable for Costs of Proceeding against Him. — If a stockholder is severally liable to pay the debts of

[1] Wheeler *v.* Millar, 90 N. Y. 353.

[2] Appeal of Andrew, 1 Pa. Supm. Ct. Cas. 126.

[3] Lane *v.* Morris, 10 Ga. 162.

[4] Laws N. Y. 1848, ch. 40, § 10.

[5] Burr *v.* Wilcox, 22 N. Y. 551; affirming *s. c.* 6 Bosw. (N. Y.) 198.

[6] Richmond *v.* Irons, 121 U. S. 27; *s. c.* 30 L. ed. 864; 7 Sup. Ct. Rep. 788.

[7] Cleveland *v.* Burnham, 64 Wis. 347. The decisions under the *English winding-up acts* on the subject of interest do not seem to have much *interest* for us; since for the most part they seem to have been made in respect of companies where the liability of the shareholders was unlimited. See cases collected in Lind. Comp., 5th ed., 724, 725. That interest on calls provided for in articles does not apply to calls in *winding-up proceedings:* Re Welsh Flannel &c. Co., L. R. 20 Eq. 360. That interest on a call runs from the date named in the *notice* for payment, see Re Overend, Gurney & Co., L. R. 3 Ch. 784.

the corporation to a certain amount, say $10,000, and a creditor has proceeded against him and obtained a judgment for this amount, can he oblige him to pay the costs of the proceeding? It has been held that he can, and the plain reason is that it was the duty of the stockholder to discharge himself of the amount for which he was liable, by paying it to the creditor, without putting him to the expense of a suit.[1]

§ 3138. Liability to Costs where the Proceeding is in Equity. — In *equity* the allowance of costs in such cases rests on a variety of considerations, and probably no rule can be stated on the subject. A corporation and its members have been held liable for the costs of a suit in equity brought against them on behalf of all the creditors of the company, founded upon simple contract debts which had passed into judgments at law, with the proviso that the amount they were decreed to pay, including such costs, should not exceed the amount of capital which they professed to have paid in, as expressed in their charter.[2] It seems that where, for the purpose of *discovery* merely, officers of a corporation are made parties to a bill, the prayer of the bill should be so framed that it will distinctly appear that all the relief sought is intended to be confined to the other defendants, and that none will be asked against such officers at the hearing, even as to costs.[3] And, even when the discovery thereby obtained is used to charge such officers personally in a supplementary proceeding, they will be allowed the costs of their answer.[4] Where a bill was filed to close up the concerns of a manufacturing company, which was alleged to have been dissolved, in fact, upon a particular day, a decree was made, upon the bill

[1] Grose *v.* Hilt, 36 Me. 22, 27; Cole *v.* Butler, 43 Me. 401, 405; Abbey *v.* Long, 44 Kan. 688; *s. c.* 9 Rail. & Corp. L. J. 94; 24 Pac. Rep. 1111. What are not "*disbursements*" entitling to compensation from the fund: Veeder *v.* Mudgett, 27 Hun (N. Y.), 519. When liability for costs disqualifies a stockholder as a *juror:* Fleeson *v.* Savage &c. Mining Co., 3 Nev. 157.

[2] Haslett *v.* Wotherspoon, 1 Strobh. Eq. (S. C.) 209.

[3] McIntyre *v.* Union College, 6 Paige (N. Y.), 239, 242.

[4] Masters *v.* Rossie Lead Mining Co., 2 Sand. Ch. (N. Y.) 301, 305.

taken as confessed, for the benefit of creditors, as to all debts which were due on the day of dissolution, as alleged in the bill and declared in the decree. A creditor who had commenced suits to recover debts due from the corporation, and who had obtained judgments therein before the decree, but after the time of dissolution mentioned in the bill and in the decree, was held to be equitably entitled to his costs in those suits up to the time when he could have come in under the decree; but, by the terms of the decree, costs were not allowed which had accrued subsequent to the day upon which the corporation was declared to have been dissolved in fact.[1] Stockholders who are defendants to a bill in equity under the Massachusetts statute, in which a decree is rendered against them, are jointly and severally liable for costs.[2]

[1] Fisk *v.* Keeseville Man. Co., 10 Paige (N. Y.), 592.

[2] Burnap *v.* Haskins Steam-engine Co., 127 Mass. 586. Liability for *calls* to defray *expenses* of winding up: Greenwood's case, 18 Jur. 118, 387; *s. c.* 23 Eng. L. & Eq. 422. As to the present rules in England, see Lind. Comp., 5th ed., pp. 864–867.

CHAPTER LIV.

STATUTES MAKING STOCKHOLDERS LIABLE FOR DEBTS DUE FOR LABOR, PROVISIONS, ETC.

SECTION
3141. Such statutes fairly construed, not extended.
3142. Illustrations.
3143. Such statutes extend to assignees of the debt.
3144. Such statutes include those who work by the piece.
3145. Do not extend to the services of professional men.
3146. Engineers of works, master mechanics, conductors, etc.
3147. Manager, superintendent, foreman.
3148. Secretary of the corporation.
3149. Book-keeper.
3150. Traveling salesman: commercial traveler.
3151. Assistant editor and reporter.
3152. Contractors.
3153. Another stockholder.
3154. Another corporation.
3155. Statutory right not waived by receiving dividend, etc.
3156. Whether waived by accepting a promissory note.
3157. Whether waived by the taking of "store orders."
3158. Application of payments by the laborer.
3159. To what stockholders liability attaches: present and past stockholders.
3160. Release by the plaintiff of some of the stockholders.
3161. Defenses available to the stockholder.
3162. Remedy at law or in equity.
3163. The complaint in such actions.
3164. Parties defendant.

§ **3141. Such Statutes Fairly Construed, not Extended.**— Statutes exist in several of the States making the stockholders in corporations formed under them jointly and severally liable for *wages* due to *laborers*, and for *supplies* and *materials* furnished in the prosecution of the work of the corporation. These statutes rest on the same policy as mechanic's lien laws, and, so far as the writer can see, do not appear to have been construed unfavorably to the special class of creditors falling fairly within their terms;[1] but the courts have refused to extend them by construction.

[1] But see Hanson *v.* Donkersley, 37 Mich. 184. Some *decisions under particular statutes* may be here noted. That Comp. Laws Mich., § 2412, make stockholders liable for labor debts only to the extent of their stock:

§ 3142. Illustrations. — Thus, the *owner of a planing-mill*, who had done certain planing at his mill for the building of a factory for a corporation, was not within a statute[1] making the stockholders jointly and severally liable "for all debts that may be due or owing to all their *laborers*, *servants*, and *apprentices*."[2] Nor did a statute making the stockholders of certain corporations "jointly and severally liable in their individual capacities only, for debts due to miners, quarrymen, and other laborers employed by such companies, and for machinery, provisions, merchandise, country produce, or materials furnished for the company,"[3] extend to a case where a partnership transferred all its assets to a corporation, receiving in payment therefor shares of the stock of the latter, and the latter agreeing to discharge the debts of the former by issuing stock to its creditors.[4]

§ 3143. Such Statutes Extend to Assignees of the Debt. — An assignment of a so-called "labor debt" does not destroy the remedy given by such a statute against the stockholders for its enforcement;[5] but it has been held that a merchant who, upon the order of a manufacturing company, furnished provisions to the hands of the company, under an arrangement by which the company took up such orders monthly, giving him their notes therefor, was entitled to the benefit of the statute.[6] Under a statute of New York[7] the *payee of a*

Peck *v.* Miller, 39 Mich. 594. That this feature of the New York Manufacturing Act of 1848 is not retained in the Act of 1875, ch. 611: Richards *v.* Beach, 19 Abb. N. C. 84. What the case must state, to bring the case within Rev. Stat. Wis., ch. 73, § 25: Harrod *v.* Hamer, 32 Wis. 162. Conditions precedent to a right of recovery under Rev. Stat. Wis., § 1769: Sleeper *v.* Goodwin, 67 Wis. 577; *s. c.* 31 N. W. Rep. 335. That the New York Railroad Acts of 1848 and 1850 would be limited to corporations created under them: Rochester *v.* Barnes, 26 Barb. (N. Y.) 657.

[1] Rev. Stat. Wis. 1858, ch. 73, § 25.

[2] Harrod *v.* Hamer, 32 Wis. 162.

[3] Pa. Act March 27, 1854; Pamph. Laws, 215; Laws Pa. 649, pl. 32.

[4] Weiss *v.* Mauch Chunk Iron Co., 58 Pa. St. 295, 304. Construction of section 10 of the New York Railroad Act of 1850, with the conclusion that it was to be restrained as intended, to secure the *daily earnings* of workmen and operatives, and not the claims of all persons rendering services: Boutwell *v.* Townsend, 37 Barb. (N. Y.) 205.

[5] *Post*, § 3737.

[6] Reading Industrial Man. Co. *v.* Graeff, 64 Pa. St. 395. To the contrary, see Weigley *v.* The Coal Oil Co., 5 Phila. (Pa.) 67.

[7] N. L. Law of 1848, ch. 40, § 18.

bill of exchange drawn on a manufacturing corporation by a laborer, to whom it is indebted for services, may maintain an action to recover the amount thereof from a stockholder.[1]

§ 3144. Such Statutes Include Those Who Work by the Piece. — It may be concluded, from the analogy of the holdings under other similar statutes giving preferences to laborers, that statutes of the kind under consideration will include laborers who work by the piece, as well as those who work by the day, week, month, or year. Thus, it has been held that a statute giving a preference as execution creditors to "mechanics and laborers" employed by certain classes of employers, includes those who work in a rolling-mill by the piece or by the ton.[2] A similar statute of Massachusetts, giving a preference to "any person who shall have performed any labor as an *operative* in the service of any insolvent," etc., has been held to include a person who received materials from the shop of the insolvent, and took them to his own shop, and there manufactured them into boots at certain prices, and delivered the manufactured articles to the insolvent.[3]

§ 3145. Do not Extend to the Services of Professional Men. — The better opinion is that statutes of this kind, using such words as "laborers," "workmen," and "servants," are intended to protect a class of persons who are wholly dependent upon their manual toil for subsistence, and who cannot otherwise protect themselves; and that they do not extend to the protection of persons whose labor or service is of a professional or *quasi*-professional character.[4]

[1] Pilcher *v.* Brayton, 17 Hun (N. Y.), 429.

[2] Seiders' Appeal, 46 Pa. St. 57.

[3] Thayer *v.* Mann, 2 Cush. (Mass.) 371.

[4] Pennsylvania &c. R. Co. *v.* Leuffer, 84 Pa. St. 168; *s. c.* 24 Am. Rep. 189; Adams *v.* Goodrich, 55 Ga. 233; Whitaker *v.* Smith, 81 N. C. 340; *s. c.* 31 Am. Rep. 503. In Stryker *v.* Cassidy, 76 N. Y. 50; *s. c.* 32 Am. Rep. 262, a supervising architect was held to be within a statute giving a mechanic's lien to any one who should perform any "labor," etc. But in New Jersey, the man who draws the plans and superintends and directs the construction of a building is held to be clearly within the provisions of such a statute. Mutual Benefit Life Ins. Co. *v.* Rowand, 26 N. J. Eq. 389. So, under the Pennsylvania statute,

§ 3146. Engineers of Works, Master Mechanics, Conductors, etc. — Thus, under the Constitution of Michigan and the

which uses the word "work" instead of labor, it is held that an operative architect and superintendent, who not only draws the plans of the building, but also directs their execution, is entitled to a lien. Bank of Pennsylvania *v.* Gries, 35 Pa. St. 423. It has been held in Missouri that an architect whose duties consist in drawing plans and specifications, and in giving directions to the builder, is not a "mechanic" within a statute relating to mechanics' liens. Raeder *v.* Bensberg, 6 Mo. App. 445; Nelson *v.* Withrow, 14 Mo. App. 270, 276; Blakey *v.* Blakey, 27 Mo. 39. To the same effect see Price *v.* Kirk (Pa. Com. Pleas), 35 Leg. Int. 325; *s. c.* 13 Phila. (Pa.) 497; Foushee *v.* Grigsby, 12 Bush (Ky.), 75; Jones *v.* Shawhan, 4 Watts & S. (Pa.) 257. So, it has been held that the agent of a corporation employed at a monthly salary to superintend the erection of buildings and the working of mines is not a "mechanic, laborman, artisan, workman, laborer, or other person," within the meaning of a statute relating to mechanics' liens. Smallhouse *v.* Kentucky &c. Co., 2 Mont. 443. In like manner, it has been held in Pennsylvania that the statute giving a mechanic's lien to "laborers and workmen" upon railroads does not include a civil engineer. Pennsylvania &c. R. Co. *v.* Leuffer, 84 Pa. St. 168; *s. c.* 24 Am. Rep. 189. So, a statute prohibiting the attachment of laborer's wages has been restrained to include only the fruits of the toil of *manual laborers*, and not the wages or earnings of contractors. Heebner *v.* Chave, 5 Pa. St. 115. See, also, Smith *v.* Brooke, 49 Pa. St. 147. So, a statute relating to the settlement of the estates of decedents, which makes *servants'* wages preferred debts, is held to mean only the earnings of such servants as are a part of a man's domestic household, and whose business it is to assist in the economy of the family, — in short, menial servants. Re Meason, 5 Binn. (Pa.) 167. See, also, Wentroth's Appeal, 82 Pa. St. 469. So, one who draws plans or makes a set of moulds for the construction of a ship is not included within a statute giving a lien to "any ship carpenter, caulker, blacksmith, joiner, or other person who shall perform labor or furnish materials for or on account of any ship." Ames *v.* Dyer, 41 Me. 397. So, in North Carolina it is held that a *farm overseer* is not a "laborer" within a constitutional provision giving to mechanics and laborers a lien upon the subject of their labor for their compensation. Whitaker *v.* Smith, 81 N. C. 340; *s. c.* 31 Am. Rep. 503. The same has been held under various statutes. In Mulligan *v.* Mulligan, 18 La. Ann. 20; Knight *v.* Norris, 13 Minn. 473, 475; and Capron *v.* Strout, 11 Nev. 304,— a superintendent, a supervising architect, and a foreman, or "boss," of mining hands, respectively, was held to be "a laborer," "a workman," or "person performing labor," within the mechanic's lien law. "By '*laborers*,'" said Woodward, J., "we mean those who perform with their own hands the contract which they make with their employer." Seiders' Appeal, 46 Pa. St. 57, 61; repeated in Wentroth's Appeal, 82 Pa. St. 469, 471. The *helpers* and *assistants* of the chief workman in an iron manufactory were within a statute giving a preference to laborers, although working by the piece or the ton. Seiders' Appeal, *supra.*

statutes of that State, stockholders in corporations are individually liable "for labor performed for such corporation." It has been held that an *assistant chief engineer* of a railway company is not a "laborer" within the meaning of such a provision.[1] So, a plaintiff charging for "professional services as a *consulting engineer*," cannot bring himself within the meaning of a statute making stockholders "jointly and severally, individually liable for all the debts that may be due and owing to all their *laborers* and *operatives* for services performed for said corporation."[2] On the contrary, one who is employed by a corporation as a *civil engineer and traveling agent*, at a fixed salary, is a "servant" under a statute making the stockholders of certain corporations personally and individually liable for debts due to their *laborers*, *servants*, and *apprentices*.[3] A distinction ought, it should seem, to be taken between *professional engineers*, in charge of railway construction or of works which require extensive scientific knowledge, and ordinary employés. Such men could hardly be classed as laborers and servants. But it has been broadly laid down that "all persons employed in the service of a railway company who have not a due, proper, and distinctive appellation, such as *officers* and *agents* of the company," are "laborers and servants,"—as, for instance, *civil engineers*, *master mechanics*, and *conductors*.[4] But it has been held that a *civil engineer* is not, within a statute giving a *lien* to "laborers" and "workmen" upon the property of a railroad company for services rendered in its construction.[5]

§ **3147. Manager — Superintendent — Foreman.** — In considering whether employés, who pass under these various

[1] Brockway *v.* Innes, 39 Mich. 47; *s. c.* 33 Am. Rep. 348.

[2] Ericsson *v.* Brown, 38 Barb. (N. Y.) 390.

[3] Williamson *v.* Wadsworth, 49 Barb. (N. Y.) 294. The court, however, rests its decision upon Richardson *v.* Abendroth, 43 Barb. (N. Y.) 162, holding that the secretary of a manufacturing corporation is a "servant" within the statute. That decision was subsequently overruled in Coffin *v.* Reynolds, 37 N. Y. 640.

[4] Conant *v.* Van Schaick, 24 Barb. (N. Y.) 87, 99; approved in Coffin *v.* Reynolds, 37 N. Y. 640.

[5] Pennsylvania &c. R. Co. *v.* Leuffer, 84 Pa. St. 168; *s. c.* 24 Am. Rep. 189.

designations, are to be regarded as "laborers," "servants," "operatives," "workmen," or the like, within the meaning of the statute, regard must, of course, be had to the sense in which the word is used, and to the nature of the employment in the particular case. A general superintendent of a corporation, with the power to employ and discharge its hands and to control their labor, is generally regarded as the *alter ego* of the corporation, in such a sense that the corporation is liable for his negligence, whereby a sub-servant suffers an injury.[1] But a mere foreman, or "boss," of a squad of hands, or of a particular job of work, is generally (though not always) regarded as a fellow-servant with the sub-servants under him, in such a sense that the corporation, or master, is not liable to a sub-servant for an injury happening in consequence of his negligence.[2] The *general manager* or *superintendent* might, therefore, by analogy, well be regarded as an *officer* of the corporation, and not within the meaning of statutes such as we are considering; while a mere foreman of work might well be regarded as a laborer or servant. Accordingly, it has been held that a *book-keeper* and *general manager* is not a laborer, servant, or apprentice, within the meaning of an act making stockholders in manufacturing corporations liable for the debts of such.[3] So, a person employed at a salary of $700 per month, payable $100 in cash and $600 in stock and bonds, to perform the duties of the *agent having superintendence* of the affairs of a gold mining corporation during his absence, was held not to be a "laborer or servant" within the meaning of such a statute.[4] In like manner, one employed by a mining corporation to *superintend its works* located in a county other than that of its principal place of business, and, when so directed by the corporation, to contract for supplies, ores, and workmen, was held not to be a "laborer, servant, or operative," within the same statute.[5] But a statute of Wisconsin,[6]

[1] 2 Thomp. Neg., pp. 1030, 1031.

[2] *Ibid.*, p. 1028.

[3] Wakefield *v.* Fargo, 90 N. Y. 213.

[4] Dean *v.* De Wolf, 16 Hun (N.Y.), 186. The statute was N. Y. act of 1848, ch. 40, § 18.

[5] Krauser *v.* Ruckel, 17 Hun (N. Y), 463.

[6] Rev. Stat. Wis. 1878, § 1769.

making stockholders personally liable for debts owing to clerks, servants, and laborers, was held to embrace a *superintendent* or *foreman of works*, although he performed no manual labor.[1] And so a person who was employed by a manufacturing corporation at a monthly salary of $1,000 per year, on condition of his obtaining for the corporation a loan of $3,000, who acted as *foreman*, helped to manufacture stone, kept the time of the hands, solicited orders, and did whatever he was told to do by the superintendent, was a laborer, or servant, within the meaning of the New York statute previously considered in this section.[2] So, an *overseer and book-keeper* has been held to be a "servant" within the meaning of the same statute, relating to manufacturing and other corporations, making stockholders individually liable for the wages of "laborers, servants, and apprentices." The court proceed upon the view that the word "laborer" in the statute may be restricted to mean one who performs manual work, but that the word "servant" cannot be confined to mere manual service.[3] It was so ruled, too, under the same statute, in the case of one who was employed by the superintendent of a mining company in a general capacity, as a sort of engineer and sort of foreman, who showed the men how to work, and yet worked with them; who, during the absence of the superintendent from the mines, was made to act as such; who sometimes kept the time of the men; and, in fact, did everything that he was ordered to do, and everything that was necessary and possible for him to do.[4]

§ **3148. Secretary of the Corporation.** — A court of New York has held that one who is the *secretary and book-keeper* does not perform labor within the meaning of the statute of Michigan, making the stockholders of manufacturing corpora-

[1] Sleeper *v.* Goodwin, 67 Wis. 577; *s. c.* 31 N. W. Rep. 335.

[2] Short *v.* Medberry, 29 Hun (N. Y.), 39.

[3] Hovey *v.* Ten Broeck, 3 Rob. (N. Y.) 316.

[4] Vincent *v.* Bamford, 42 How. Pr. (N. Y.) 109; *s. c.* 1 J. & Sp. (N. Y.) 506. It has been held that one who furnishes nothing but his superintendence and skill as an undertaker of work cannot file the lien of a mechanic. Jones *v.* Shawhan, 4 Watts & S. (Pa.) 257.

tions liable for all labor performed for the company, but only after judgment rendered against the corporation and execution returned unsatisfied. The court, while holding that the statute should be construed according to the construction placed upon it by the courts of Michigan, said that neither under the law of Michigan nor the law of New York would such services be deemed "labor" within the meaning of such a statute.[1] That the secretary of a corporation is one of its *officers*, and is not a "laborer" within the meaning of such a statute, had been previously held by the Court of Appeals of New York; but in reaching so plain a conclusion the court was obliged to overrule a decision of the Supreme Court of that State.[2]

§ **3149. Book-keeper.** — But a mere *book-keeper*, having no other duties than such as usually pertain to that position, is a "servant" within a statute[3] making stockholders of a corporation liable personally for wages due its *laborers, servants*, and *apprentices.*[4]

§ **3150. Traveling Salesman: Commercial Traveler.** — A *traveling salesman* employed by a corporation is not a "laborer," within the meaning of a constitutional provision which makes a stockholder liable for labor debts.[5] But if he spends part of the time on the road selling goods, making collections, etc., and the rest of the time *working in a store*, shipping and receiving goods, moving and handling stock, making sales, and collecting bills in the city, he is a "clerk," within the meaning of a statute[6] making stockholders individually liable for moneys due "laborers, servants, clerks, and operatives," in case the corporation becomes insolvent.[7]

§ **3151. Assistant Editor and Reporter.** — The meaning of the word "labor" in such a statute is not necessarily restrained

[1] Citing Viele *v.* Wells, 9 Abb. N. C. (N. Y.) 277.

[2] Coffin *v.* Reynolds, 37 N. Y. 640; overruling Richardson *v.* Abendroth, 43 Barb. (N. Y.) 162.

[3] Laws N. Y. 1848, ch. 40, § 18.

[4] Chapman *v.* Chumar, 7 N. Y. Supp. 230.

[5] Jones *v.* Avery, 50 Mich. 326.

[6] Tenn. Gen. Corp. Act, 1875, § 11.

[7] Hand *v.* Cole, 88 Tenn. 400; *s. c.* 7 L. R. A. 96; 12 S. W. Rep. 922.

to manual labor, but may include *bookish* or *liberal* labor. Accordingly, it has been held that an *assistant city editor and reporter* is a "laborer" within the meaning of such an act.[1]

§ **3152. Contractors.** — So, a *contractor* for building a portion of a railway is not included within the words "laborers or servants" in a statute making stockholders liable for debts owing by the corporation to such persons.[2] Nor does such a statute embrace the case of one who has contracted for labor by his *team of horses*.[3] The same was held in a case where, by the terms of the contract between the contractors and the corporation, he was to carry on certain quarrying operations at his own expense, and for a period of years, in a quarry *owned by the corporation*, and deliver rock to the corporation at certain rates.[4] Nor was one who had a contract to deliver lumber, and who performed it by hiring teams and drivers, a "laborer," giving a preference to laborers in the distribution of funds arising from an execution sale.[5]

§ **3153. Another Stockholder.** — A *person who has held stock* in a corporation cannot maintain a suit under the statute against the other stockholders to recover a debt due him from the corporation for services performed by him as its servant;[6] and this, although he has assigned or pledged it, provided he has not made a transfer of it on the books of the corporation, — for until such a transfer, he remains the legal owner. The statute was not intended to give such a remedy to one stockholder against another.[7]

[1] Harris *v.* Norval, 1 Abb. N. C. (N. Y.) 127; *s. c.* 17 Am. Law Reg. 97; 14 Alb. L. J. 432.

[2] Aikin *v.* Wasson, 24 N. Y. 482; Boutwell *v.* Townsend, 37 Barb. (N. Y.) 205. To the same effect, under the Michigan statute, see Peck *v.* Miller, 39 Mich. 594.

[3] Balch *v.* New York &c. R. Co., 46 N. Y. 521. The reverse was held by the Supreme Court of Wisconsin in Hogan *v.* Cushing, 49 Wis. 169, in respect of a statute giving a lien "for labor and services upon logs."

[4] Taylor *v.* Manwaring, 48 Mich. 171.

[5] Wentroth's Appeal, 82 Pa. St. 469.

[6] Richardson *v.* Abendroth, 43 Barb. (N. Y.) 162.

[7] *Ibid.* See *ante*, § 3125.

§ 3154. Another Corporation.— A *corporation aggregate* could not be the "employé" of another corporation within the meaning of such a statute.[1]

§ 3155. Statutory Right not Waived by Receiving Dividend, etc.— Under such a statute, it is held that a servant does not, by taking a note and obtaining judgment against the corporation for such wages, and by receiving a *pro rata* dividend of the corporate assets upon such judgment, waive his rights against the individual shareholders.[2]

§ 3156. Whether Waived by Accepting a Promissory Note. The Supreme Court of Michigan has adopted the view that under a statute of that State,[3] making stockholders in certain corporations liable for work and labor done for the corporation, the liability of the stockholders is *secondary,*— in the nature of that of *sureties.* Hence, where the laborer indulged the company in the matter of time, and accepted a promissory note in payment, and afterwards sued the company, and recovered judgment thereon, he could not recover against a stockholder.[4] We shall see, in another chapter,[5] that the prevailing doctrine is, that the liability of stockholders is so far *secondary* that the creditor cannot proceed against them while he has recourse against the company. But the opinion of the majority of the Michigan court is an isolated view, and one manifestly tending to obstruct the policy of the statute, which

[1] Dukes *v.* Love, 97 Ind. 341. The statute construed was Ind. Rev. Stat. 1881, § 3869.

[2] Jackson *v.* Meek, 87 Tenn. 69; *s. c.* 10 Am. St. Rep. 620; 9 S. W. Rep. 225; 4 Rail. & Corp. L. J. 564; construing Tenn. acts of 1875, ch. 142, § 21.

[3] The statute, so far as is material to the question, is as follows: "The stockholders of all corporations founded upon this act shall be individually liable for all labor performed for such corporation, which said liability may be enforced against any stockholders, by action founded on this statute, at any time after an execution shall be returned and not satisfied, or at any time after an adjudication in bankruptcy against such corporation." 1 Comp. Laws Mich. 1871, § 2852.

[4] Hanson *v.* Donkersley, 37 Mich. 184. Marston, J., dissented, and his view more nearly accords with the current of opinion.

[5] *Post,* § 3351.

is to secure to the laborers and servants of corporations their wages. In Tennessee, the better view is taken, that an employé of a corporation, who accepts its note for the wages due him, and attempts to collect from the corporate assets, does not thereby waive his right to enforce his claim for wages against the individual stockholders.[1]

§ **3157. Whether Waived by the Taking of "Store Orders."** A decision of the Supreme Court of Michigan is to the general effect that where the secretary and treasurer of a mining corporation conduct, as a partnership firm, a "truck store," if the corporation gives to its employés orders upon this store, and the partnership conducting it becomes insolvent, the taking of the orders deprives the employés of recourse against the stockholders of the corporation.[2]

§ **3158. Application of Payments by the Laborer.** — Where the statute limits the remedy of the servant or laborer to debts due for wages, not exceeding six months in any one case,[3] and the corporation keeps a running account with a laborer, and no particular application of an amount paid him within six months is made, he may apply it in payment of wages first earned by him.[4] This is but the application of the general rule, that wherever the debtor does not exercise his right of directing the application of payments, the cred-

[1] Jackson *v.* Meek, 87 Tenn. 69; *s. c.* 10 Am. St. Rep. 620; 9 S. W. Rep. 225.

[2] Beecher *v.* Dacey, 45 Mich. 92. The decision is believed to be grossly untenable and unjust. The effect of the order was not the substitution of another creditor, because it did not contain any agreement to that effect. It was not a *payment* until, in the absence of negligence in presenting it, it had been satisfied by the delivery of the amount of goods specified in it. Its plain import was that the original debtor undertook that the store would pay the debt for it, and when the store failed to do this, the liability of the company was revived. The case was not different in law, though much worse in morals, than it would have been if the corporation had given the employé a check upon an insolvent bank, which had been dishonored on presentment. Upon what theory could it, then, claim that its stockholders had become exonerated from the liability of the statute?

[3] Rev. Stat. Wis. 1878, § 1769.

[4] Sleeper *v.* Goodwin, 67 Wis. 577; *s. c.* 31 N. W. Rep. 335.

itor may apply them so as to save whatever right he may thereby save.[1]

§ 3159. To What Stockholders Liability Attaches: Present and Past Stockholders. — A statute of Indiana[2] which provides that "all members," etc., "shall be personally liable for all debts contracted by the company for manual labor performed for the company," does not render a stockholder liable for debts of the company contracted *before he became a member.*[3] On the other hand, stockholders are not relieved, under the Tennessee statute, by a transfer of their stock, from their individual liability to employés of the corporation for wages previously earned.[4]

§ 3160. Release by the Plaintiff of Some of the Stockholders. — Where, under the governing statute, the liability of the stockholders, is *several* as well as joint,[5] — it has been held that the plaintiff, proceeding under such a statute against stockholders, for services as laborer, etc., may *release* some of the defendants, without affecting his right to recover the balance of his claim from the others.[6] But the decision rests the plaintiff's right to recover upon another statute "for the relief of partners and joint debtors,"[7] which authorizes one or more joint debtors to compromise their joint indebtedness in discharge of their joint liability, without affecting the liability of the other joint debtors.

§ 3161. Defenses Available to the Stockholder. — Besides the defenses suggested by what has preceded in another title, and what will follow in this chapter, most of the defenses which are available to the stockholder proceeded against to

[1] Brady *v.* Hill, 1 Mo. 315; *s. c.* 13 Am. Dec. 503; Harker *v.* Conrad, 12 Serg. & R. (Pa.) 301; *s. c.* 14 Am. Dec. 691; Cremer *v.* Higginson, 1 Mason (U. S.), 338; Youmans *v.* Heartt, 34 Mich. 397, 401. Notes, 13 Am. Dec. 505, and 14 Am. Dec. 694.

[2] 3 Ind. Rev. Stat. 222, § 16.

[3] Reeder *v.* Maranda, 66 Ind. 485.

[4] Jackson *v.* Meek, 87 Tenn. 69; *s. c.* 10 Am. St. Rep. 620; 9 S. W. Rep. 225; 4 Rail. & Corp. L. J. 564.

[5] N. Y. act of 1848, ch. 40, § 18.

[6] Herries *v.* Platt, 21 Hun (N. Y.), 132.

[7] N. Y. act of 1838, ch. 257.

enforce an individual liability, are available to him here. Here, as in other cases,[1] he may escape liability by proof that he has not been a stockholder, or that he was not a stockholder within the period when, by operation of the statute, liability attached to the stockholders for the particular debt.[2] He may plead the *statute limiting* the period within which such an action may be brought against the stockholders.[3] He may plead a previous *payment* and the exhaustion of his liability under limitations elsewhere considered; and it seems that, under the New York statute,[4] he is absolutely discharged from his liability, by paying to any creditors for whose debts he is liable an amount equal to his stock;[5] while under the Massachusetts statute[6] it is no ground of defense to one of the defendants that he has paid some of the operatives other sums due them, and has a claim for contribution upon the other defendants.[7] Under another section of the statute of New York,[8] if the stockholder has made advances to the company, and has a claim therefor, his liability is not affected by the question whether the money advanced was used to pay debts for which he was individually liable, or not.[9] Such defense is valid, although the advances were to pay the workmen, even if the liability imposed by section 18 on the stockholders to pay laborers was in addition to that to pay creditors.[10] As such defense is not based on his payment of his personal liability, but on his interest in the fund as a creditor, the *limitation* in section 24 to debts payable within one year does not apply.[11] It is no defense to the stockholder, under the Wisconsin statute, and, it may be assumed, under other possible statutes of this kind, that the corporation has been *dis-*

[1] *Post,* § 3691.

[2] Powell *v.* Eldred, 39 Mich. 552.

[3] Arno *v.* Wayne Circuit Judge, 42 Mich. 362. In this case the Michigan act 113, of 1877, was severely criticised for limiting to two years the period within which suit might be brought against a stockholder of a manufacturing corporation for a labor debt.

[4] N. Y. Laws of 1840, ch. 40, § 18.

[5] Mathez *v.* Neidig, 72 N. Y. 100.

[6] Mass. Stat. 1870, ch. 224, § 42.

[7] Burnap *v.* Haskins Steam-Engine Co., 127 Mass. 586.

[8] N. Y. Laws of 1848, ch. 40, § 12.

[9] Mathez *v.* Neidig, 72 N. Y. 100.

[10] *Ibid.*

[11] *Ibid.*

solved by its own voluntary act; that no *judgment* has been recovered against the corporation; that no *receiver* of the assets of the corporation has been appointed, or other means taken to ascertain whether a dividend in favor of creditors may not be made; or that the plaintiff has *presented his claim* for the purpose of receiving and sharing in a dividend.[1]

§ **3162. Remedy at Law or in Equity.** — One who has performed labor as an *operative* for a corporation organized under a statute of Massachusetts,[2] cannot maintain an action at law against a stockholder to recover for the same.[3] This ruling is based upon the view that the proper mode in which stockholders can be charged, in the absence of any specified remedy, is by *bill in equity;* that it would be very vexatious and oppressive to render the stockholders liable to separate suits at law for the small sums which might be due to each operative for labor performed in behalf of the corporation; and that such a remedy would be less advantageous to creditors than that afforded in a court of equity, where the claims of all might be adjusted and enforced in a single suit, brought by one or more having similar claims on the corporation. But it cannot escape attention that to drive an operative to a bill in equity to collect a small labor debt must, in many cases, be tantamount to a denial of the right; and, therefore, it is more satisfactory to know that the Massachusetts court found itself obliged to take this view from the fact that the statute prescribed the same remedy which was prescribed by another statute. Now, that other statute had not in terms prescribed any remedy, but it had long been settled that the only remedy under it was a bill in equity, and this construction of it the Legislature must have known when it enacted the statute under consideration. The Supreme Court of Wisconsin, dealing with this subject under a statute of Michigan, which provides that "said liability may be enforced by action in *assumpsit,*"

[1] Sleeper *v.* Goodwin, 67 Wis. 577; *s. c.* 31 N. W. Rep. 335.

[2] Mass. Stat. 1851, ch. 133.

[3] Bell *v.* Spaulding, 3 Allen (Mass.), 485.

and that "suit for such labor may be commenced against any or all the stockholders jointly," holds that this is a case where a statute creates a right, and gives a special remedy to enforce it, which remedy cannot migrate, but is confined to the courts of Michigan.[1] The decision seems to be untenable. The action of *assumpsit*, in vogue in Michigan, is included, in its scope and meaning, in the civil action in vogue in Wisconsin, under the code of that State, and the Michigan statute allows the action to be prosecuted against *any* stockholder; and the statute, being remedial in the same sense as other laws securing preferences to laborers in the collection of their wages, ought to be enforced in any jurisdiction where a stockholder may be found.

§ **3163. The Complaint in such Actions.** — Where the condition of the statute[2] is that the labor debts must have been contracted to be paid within *one year*, the plaintiff must allege that the debt which is the subject of the action was so contracted.[3] Under a statute of Indiana,[4] which makes stockholders in a railroad corporation individually liable to laborers for all labor done in the construction of the road that shall remain unpaid after the assets of the corporation shall have been exhausted, a complaint which alleges that defendants have subscribed to the stock of a certain railroad company, that plaintiffs hold certain judgments against the company, one of which is for work and labor, and that the company is insolvent, does not state a cause of action, since it does not show that plaintiff's claims are for labor done in the construction of the road.[5]

§ **3164. Parties Defendant.** — A servant who brings an action under the New York statute,[6] making all the stockholders parties defendant, cannot thereafter discontinue as to

[1] May *v.* Black, 77 Wis. 101; *s. c.* 45 N. W. Rep. 949; *ante*, § 2936, *et seq.*

[2] N. Y. Laws 1848, ch. 40, §§ 18, 24.

[3] Dean *v.* Mace, 19 Hun (N. Y.), 391. See, further, as to allegation, proof, and procedure under the same statute, Dempsey *v.* Willett, 16 Hun (N. Y.), 264.

[4] Rev. Stat. Ind. 1881, § 3934.

[5] Toner *v.* Fulkerson, 125 Ind. 224; *s. c.* 25 N. E. Rep. 218.

[6] N. Y. Laws 1848, ch. 40, § 18.

one without the consent of the others.[1] If the right to sue a stockholder for a labor debt of his corporation became complete before the passage of the Michigan act of 1877, providing that the *corporation* might be made a *joint defendant*, the plaintiff could still proceed as at common law, under another statute,[2] against the stockholder alone.[3]

[1] Dean *v.* Whiton, 16 Hun (N. Y.), 203.

[2] Mich. Comp. L., § 2852.

[3] Tilden *v.* Young, 39 Mich. 58.

CHAPTER LV.

TO WHAT CLASS OF SHAREHOLDERS LIABILITY ATTACHES: PRESENT AND PAST MEMBERS.

SECTION
3169. Rule in regard to partners.
3170. General rule in regard to stockholders.
3171. Past members not liable unless by statute.
3172. Statutory liability of past members in America.
3173. Exceptional rule of liability as partners attaching to those who were stockholders when debt contracted.
3174. Results of these divergent views.
3175. Stockholders becoming such subsequent to repeal not subject to double liability.
3176. Liability for debts contracted before membership.
3177. Exception where the liability is that of partners.
3178. Exception where the liability is in the nature of a penalty for a wrongful act.
3179. As for contracting debts before stock paid in.

SECTION
3180. Statutes under which liability attaches to those who are members at the time the liability is sought to be enforced.
3181. Statutes fixing liability upon those who were stockholders when payment refused.
3182. At the time of the commencement of the action against the corporation.
3183. At the time when suit brought to charge stockholders.
3184. At the time of suing out *scire facias* for execution against the stockholder.
3185. At the time when execution against corporation returned *nulla bona*.
3186. Assignee of shares not liable for fraudulent dividends received by his assignor.
3187. Effect of renewals.

§ **3169. Rule in Regard to Partners.** — The rule in regard to partnerships is, that liability for the payment of the partnership debts attaches only to those *who were partners when the debts were created.* This is obvious. The retiring of a partner operates as a dissolution; the incoming of a new partner creates a new firm; the former is not answerable for debts created after he retired,[1] nor is the latter for debts created

[1] Brett's case, L. R. 6 Ch. 804, *per* Lord Hatherley, L. C.

before he came in, unless he has made himself so by covenants of which creditors are entitled to avail themselves.[1]

§ 3170. General Rule in Regard to Stockholders. — But, in the absence of special statutory provisions, the general rule, applicable alike to the English joint-stock company and the American corporation, is, that liability as contributories or to creditors *follows the shares*,[2] and attaches, not merely to those who were members at the time, or before, the debt was contracted, but to those who were such either (1) when, by reason of the stoppage, dissolution, or winding-up[3] of the company, the right to transfer shares ceased; or, (2) in the case of direct proceedings by creditors against shareholders, when the right of the creditor against the shareholder became fixed in an appropriate proceeding.[4] It follows that in an action to enforce the individual liability of a shareholder under a statute, a recovery may be had against him, although he was not a shareholder when the creditor's cause of action accrued.[5] "The liability being because of the ownership of the stock, it follows the stock into whosesoever hands it may go, and whoever purchases it does so at the risk of this liability."[6] Proceeding on the same view, it is said that "the expression 'all stockholders' must be regarded, in the absence of any legislative indication to the contrary, as including, not only those who were such at the time the indebtedness was

[1] Brett's case, L. R. 6 Ch. 804, *per* Lord Hatherley, L. C.

[2] Williams *v.* Hanna, 40 Ind. 535, 544; Chesley *v.* Pierce, 32 N. H. 388.

[3] Castello's case, L. R. 8 Eq. 504; Symons' case, L. R. 5 Ch. 298.

[4] Nixon *v.* Green, 11 Ex. 550; *s. c.* affirmed, 25 L. J. Ex. 209; *s. c.* 3 Hurl. &. N. 686; 27 L. J. Ex. 509; Dodgson *v.* Scott, 2 Ex. 457; Longley *v.* Little, 26 Me. 162; Bond *v.* Appleton, 8 Mass. 472; *s. c.* 5 Am. Dec. 111; Child *v.* Coffin, 17 Mass. 64; Middletown Bank *v.* Magill, 5 Conn. 28; Deming *v.* Bull, 10 Conn. 409; McClaren *v.* Franciscus, 43 Mo. 452. *Contra, infra*, § 3173. The language of the text is the same as in the author's work on stockholders, at § 90. It was quoted with approval by the Supreme Court of Illinois in Root *v.* Sinnock, 120 Ill. 350; *s. c.* 60 Am. Rep. 558, 562.

[5] Root *v.* Sinnock, *supra;* distinguishing Buchanan *v.* Meisser, 105 Ill. 638; Thompson *v.* Meisser, 108 Ill. 359; Culver *v.* Third Nat. Bank, 64 Ill. 528; Fuller *v.* Ledden, 87 Ill. 310; Hull *v.* Burtis, 90 Ill. 213.

[6] *Ibid.*, *per* Scholfield, J. See, also, Thebus *v.* Smiley, 110 Ill. 316.

incurred, but all those who successively stand in their shoes in respect to the same stock."[1]

§ 3171. Past Members not Liable unless by Statute. — The general, and, it is believed, the universal, rule is, that members who have *bona fide* transferred their shares to others before the institution of proceedings to charge the stockholders are no longer liable in any form for the debts of the corporation, unless their liability has been continued by statute.[2] This seems to result from the nature of the compact which exists among the shareholders. When one shareholder passes out and substitutes another in his stead, he is discharged from all right to participate in the management or in the benefits of the corporation, and for equal reasons is discharged from liability to its creditors, unless there is a statute which holds him to that liability. The reason for this general conclusion has been thus stated by Sir Nathaniel Lindley: "As a general

[1] Brown *v.* Hitchcock, 36 Ohio St. 667, 681. See, also, Wheelock *v.* Kost, 77 Ill. 296, 298. This was the *general rule*, under the former *English winding-up acts*, where the liability as contributories attached to those who stood on the register at the time of the commencement of winding-up proceedings, and not to previous transferors or to subsequent transferees. Under the Companies Act, 1862, this rule is somewhat varied, so that no past member is liable to contribute if he has ceased to be a member for a year or more before the commencement of the winding-up proceeding, or in respect of any debt or liability contracted after he ceased to be a member; and, further, no past member is liable to contribute, unless the existing members are unable to pay their contributions. The difficulties which have been encountered in applying this statute may be seen from Lind. Comp., 5th ed., pp. 816, 855. Some further explanation of these statutes may be gathered from Thomp. Stockh., §§ 97, 98. There were formerly, in England, companies whose deeds of settlement prescribed a rule different from the general law, by making each member liable for his proportion of the losses sustained by the company up to the time of transferring his shares. A provision of this kind was pronounced by Vice-chancellor Kindersley a "most unfortunate clause," but no legal objection was found to it; they could only invoke that clause of the statute of limitations applicable to specialty debts. Helby's Case, L. R. 2 Eq. 167. Non-liability of "advanced shareholders" in building associations, on the ground that they had, upon redemption of their shares under the rules, "ceased to be members" of the society: Re Doncaster &c. Building Society, L. R. 3 Eq. 158.

[2] *Post*, § 3221.

rule,[1] a member of a company, whose shares have been duly transferred, surrendered, or forfeited, is discharged, as between himself and the other members, from all liability, as well in respect of past as of future transactions; the acceptance by the company of the transfer or surrender, or the declaration by the company of the forfeiture, being, generally speaking, equivalent to a release by the company of the member whose shares are thus dealt with, from all liability in respect of them. Where this is the case, he is not liable, on the subsequent winding-up of the company, to be put on the list of contributories with the present members; and his liability to be put on the list at all can only arise from some necessity of having recourse to past members, in order to pay the debts of the company or to adjust the rights of such members *inter se*."[2]

§ 3172. Statutory Liability of Past Members in America.— There are also statutes in America which continue the liability of shareholders for limited periods after they have ceased to be such. Thus, a statute of Maine, after declaring and defining the liability of shareholders to creditors, continued: "And such liability shall continue, notwithstanding any subsequent transfer of such stock, for the term of one year after the record of the transfer thereof on the books of the corporation, and for the term of six months after judgment recovered against such corporation in any suit commenced within the year aforesaid."[3] This statute has been held to apply only to suits against stockholders who had transferred their shares regularly on the books, and not to shareholders who had never parted with their shares.[4] Under another like statute

[1] "There are exceptions, as in Helby's Case, L. R. 2 Eq. 167, and others of that class. By the Stannaries Act, 1887, 50 & 51 Vict., ch. 43, § 22, the relinquishment of a share in a mine subject to that act has no effect if the company goes into liquidation within six weeks."

[2] Lind. Comp., 5th ed., 816. This was the rule prior to the Companies Act, 1862, above referred to. It is said, further on, by Sir N. Lindley: "Under the Winding-up Acts of 1848 and 1849, the liability of a late shareholder, to be made a contributory, depended upon the simple question whether he had, as between himself and the company, got rid of the obligations which, by supposition, he was under." Lind. Comp., 5th ed., 817.

[3] Rev. Stat. Me. 1841, ch. 76, § 18.

[4] Ingalls *v.* Cole, 47 Me. 530.

in that State,[1] it has been held that a judgment creditor of a corporation, seeking to recover the amount of his judgment, or any part thereof, from a stockholder who has not fully paid up his stock, must show that he has recovered a lawful and *bona fide* judgment within two years next prior to his action; that defendant has not paid for stock which he subscribed for or agreed to take; that the original cause of action was contracted during defendant's ownership of such unpaid stock; and that proceedings against the corporation were commenced during defendant's ownership, or within one year after its transfer was recorded on the corporation books.[2] Of course, such statutes apply only to *debts contracted during the time when the stockholder was a member or prior thereto;* for it would be intolerable for the Legislature to make a man liable for the debts of a corporation created after he has ceased to be a member of it, except where he retired while indebted to the corporation in respect of his shares. It is, of course, competent for the Legislature to abolish the rule of the common law,[3] under which a shareholder, whose shares have not been paid for, but who transfers them to another with notice that they are assessable, relieves himself of his liability to pay to the corporation the unpaid balance, and passes that liability over to his vendee. We have seen that the corporation itself may, under some conceptions, establish a *by-law* restraining the transfer of its shares, so long as the shareholder is indebted to it in respect of them;[4] and, of course, the Legislature may enact a statute providing that shareholders who assign their shares shall remain liable for any unpaid balances due to the corporation thereon, and this, although the assignee may also

[1] Rev. Stat. Me., ch. 46, §§ 46, 47.

[2] Libby *v.* Tobey, 82 Me. 397; *s. c.* 19 Atl. Rep. 904. It has been held that if the officers of a joint-stock company incorporated under statute 1851, chapter 133, have made and deposited the certificate, provided for by section 9 of that statute, as authorized by statute 1854, chapter 438, they will not be personally liable for a debt contracted by the company before the expiration of the month of the following year which corresponds with that in which the certificate was so deposited. Bond *v.* Clark, 6 Allen (Mass.), 361.

[3] Marr *v.* Bank of West Tennessee, 4 Lea (Tenn.), 578. Compare *ante,* §§ 3033, 3034.

[4] *Ante,* §§ 1032, 2321.

become liable. Such is the effect of a statute of Virginia.[1] Under this statute the liability of the assignor and assignee is *not joint*, but is several, so that a *release* of the assignor by the trustee of the insolvent corporation, under a statute authorizing compromises in such cases, does not release the assignee.[2] Similar to this was a bank charter which received interpretation at the hands of the Supreme Court of Illinois, which provided that "each stockholder shall be liable to double the amount of stock held or owned by him, and for three months after giving notice of transfer," etc. It was held that this rendered the stockholder liable for debts incurred while he was a member, and also for such debts as the bank might contract during the three months ensuing, after giving notice of a transfer of his stock.[3] The liability was a *primary*, and not a *secondary*, liability; so that an action of debt lay directly against him by the creditor of the corporation. Nor did the clause relate to the time within which the suit must be brought to enforce his liability; and he was consequently not released from it by not being sued within three months after transfer.[4]

§ 3173. Exceptional Rule of Liability as Partners Attaching to Those Who were Stockholders when Debt Contracted. — Formerly, in New York, and still, it seems, in other States, an exceptional rule obtains under which the test of liability is that the stockholder was such *at the time the debt was contracted*.[5] The foundation of this rule is that the statute makes

[1] Code Va. 1860, tit. 18, ch. 57; Code Va. 1873, ch. 57, § 26; Hamilton *v.* Glenn, 85 Va. 901; 9 S. E. Rep. 129; 13 Va. Leg. 242; McKim *v.* Glenn, 66 Md. 479; 8 Atl. Rep. 130; Hambleton *v.* Glenn, 72 Md. 331; 20 Atl. Rep. 115; Glenn *v.* Priest, 51 Fed. Rep. 400; Glenn *v.* Priest, 48 Fed. Rep. 19; Glenn *v.* Dorsheimer, *Id.;* Morris *v.* Glenn, 87 Ala. 628; 7 South. Rep. 90; 13 Va. L. J. 224.

[2] Glenn *v.* Foote, 36 Fed. Rep. 824.

[3] Fuller *v.* Ledden, 87 Ill. 310.

[4] *Ibid.* Under the Tennessee General Banking Act of 1859-1860, an original subscriber to the stock of a bank was liable for the whole amount of his subscription, although he has assigned his stock; and it was immaterial that the bank was chartered before the passage of the act. The assignee, however, was first liable. The act is *constitutional.* Marr *v.* West Tennessee Bank, 4 Lea (Tenn.), 578.

[5] Moss *v.* Oakley, 2 Hill (N.Y.), 265; Judson *v.* Rossie Galena Co., 9 Paige (N. Y.), 598; *s. c.* 38 Am. Dec. 569; Tracy *v.* Yates, 18 Barb. (N. Y.) 152; Adderly *v.* Storm, 6 Hill, 624; Harger *v.* McCullough, 2 Denio, 119; Free-

(or leaves) the stockholders liable *as partners*; and the meaning of such a statute is that when a debt is contracted by the corporation, the liability of those who are *then* stockholders

land *v.* McCullough, 1 Denio, 414; *s. c.* 43 Am. Dec. 685; McCullough *v.* Moss, 5 Denio, 567; Mokelumne &c. Co. *v.* Woodbury, 14 Cal. 265; Davidson *v.* Rankin, 34 Cal. 503; Larrabee *v.* Baldwin, 35 Cal. 155; Williams *v.* Hanna, 40 Ind. 535; Chesley *v.* Pierce, 32 N. H. 388; Bordman *v.* Osborn, 23 Pick. (Mass.) 295. Compare Lewis *v.* Ryders, 13 Abb. Pr. (N. Y.) 1. This rule has been declared under Ohio statutes in respect of street railroad companies. Brown *v.* Hitchcock, 36 Ohio St. 667. The rule appears to have been otherwise under the New York banking and manufacturing acts. Re Empire City Bank, 8 Abb. Pr. (N. Y.) 192; Cushman *v.* Shepard, 4 Barb. (N. Y.) 113. The *complaint* must show that the defendant was a stockholder at the time when the debt was contracted. Young *v.* New York &c. Steamship Co., 15 Abb. Pr. (N. Y.) 69. The California statute, construed in Mokelumne *v.* Woodbury, and other cases above quoted, prescribes this rule of liability in express terms, and so does the present provision of the Constitution of California (*ante*, § 2891); and so did the statute which governed the decision of Mr. Justice Story in Carver *v.* Braintree, 2 Story (U. S.), 432, 437. The Pennsylvania Act of April 20, 1853, supplementary to the act of April 7, 1849, rendered the stockholders in all corporations incorporated under its provisions or under the act of 1849, and its supplements, liable for all debts contracted while they were stockholders, although they had paid up the whole of their stock. Patterson *v.* Wyomissing &c. Co., 40 Pa. St. 117. Under the Massachusetts statute making the stockholders individually liable for the corporate debts in certain cases, a member of a manufacturing company might be liable for the debts of the company contracted while he was a member, although he ceased to be such before the debts became payable; but he was not liable for debts contracted before he became a member, if his membership expired before the debts became payable and action brought. Holyoke Bank *v.* Burnham, 11 Cush. (Mass.) 183. And see Mill Dam Foundry *v.* Hovey, 21 Pick. (Mass.) 417, 454. The reader should note that the decision in Rosevelt *v.* Brown, 11 N. Y. 148, 151, was under a statute providing that, "for all debts which shall be owing by the company at the time of its dissolution, the persons *then composing* such company shall be individually responsible," etc., which exacted a different rule from that in Moss *v.* Oakley, 2 Hill (N. Y.), 265, and other New York cases above quoted. The reader should also be careful to note that, although in McCullough *v.* Moss, 5 Denio (N.Y.) 567, the Court for the Correction of Errors reversed the court below (5 Hill (N. Y.), 131), yet there was another question involved in the case, on which it probably turned, and that four senators, Lott, Van Schoonhoven, Barlow, and Talcott, were of opinion that liability attached only to those who were shareholders at the time the debt was contracted, while Senator Putnam alone is reported to have expressed a contrary opinion. The fifth and sixth paragraphs of the reporter's head-note are, therefore, essentially erroneous; and this, probably, led Judge Wagner, in McClaren *v.* Franciscus, 43 Mo. 464, into the erroneous statement that the New

attaches, and that, from that moment, they become bound in the same manner, and with like effect, as if they had been doing business as partners unincorporated, except that the liability of each stockholder is limited to the amount prescribed by the statute, — generally an amount equal to the par value of the stock held by him.[1] The rule is *exclusive* as well as *inclusive*, and under it such liability attaches *only* to those who were stockholders at the time when the debt was contracted, unless the statute provides otherwise.[2]

§ **3174. Results of these Divergent Views.** — Important results flow from the divergent views of the American courts on this subject. We have already seen[3] that where stockholders are liable as original undertakers or partners, the *statute of limitations* begins to run in their favor from the time of the contraction of the debt by the corporation. Moreover, where this rule obtains there can be no *fraudulent transfers* of shares, such as obstruct creditors and perplex the courts under the other rule,[4] because even a valid transfer does not divest liability.

§ **3175. Stockholders becoming such Subsequent to Repeal not Subject to Double Liability.** — By parity of reasoning, where a State constitution makes each stockholder in a corporation individually liable for its debts, over and above the stock held by him, in a further sum at least equal in amount to such stock; and the corporation incurs debts, and is then

York Court for the Correction of Errors had disapproved the doctrine of the Supreme Court, that liability attached only to those who were members when the debt was contracted. The point, however, is immaterial; for the decisions of the court for the correction of errors — a political body — had at that time ceased to command the respect of the profession or the obedience of the lower courts of New York, and was soon after abolished, the present Court of Appeals taking its place.

[1] Schalucky *v.* Field, 124 Ill. 617; *s. c.* 7 Am. St. Rep. 399; Fuller *v.* Ledden, 87 Ill. 310; Thompson *v.* Meisser, 108 Ill. 359.

[2] Chesley *v.* Pierce, 32 N. H. 288; Windham Provident Inst. *v.* Sprague, 43 Vt. 502; Moss *v.* Oakley, 2 Hill (N. Y.), 265; Judson *v.* Rossie Galena Co., 9 Paige (N. Y.), 598; *s. c.* 38 Am. Dec. 569.

[3] *Ante*, § 3071.

[4] *Post*, § 3255, *et seq.*

authorized to obtain subscriptions for new stock, but does not obtain them; and the constitution of the State is afterwards amended, and declares that in no case shall any stockholder be individually liable in any amount over and above the amount of stock held by him; and the corporation then for the first time issues the new stock, — the holders of such new stock are not personally liable under the first constitution, though the amended constitution does not impair the obligation of the contract between the corporation and its debtor under the first constitution.[1]

§ 3176. Liability for Debts Contracted before Membership. — From the premise that liability follows the shares,[2] the conclusion is stated, with entire confidence, to be that shareholders are liable on the insolvency of the corporation, to the extent of their contract of subscription or of the superadded statutory imposition, for the debts of the corporation contracted before they became members, as well as for the debts contracted during their membership.[3]

§ 3177. Exception where the Liability is that of Partners. There is ground for exception to the foregoing rule where the liability is that of *partners*.[4] In such a case, as already seen,[5] those only were liable who were stockholders at the time the debt was contracted, and these do not escape liability by transferring their shares and introducing new members.[6] And, as in a simple partnership, a member is not liable for debts contracted by his copartners *before he became a member* of the firm, so where stockholders are made personally liable for all the debts of the corporation, they have been held not liable for such as were contracted before they became stockholders.[7]

[1] Ochiltree *v.* Railroad Company, 21 Wall. (U. S.) 249; affirming *s. c. sub nom.* Ochiltree *v.* Iowa &c. R. Co., 54 Mo. 113. Compare *ante*, § 3040.

[2] *Post*, § 3221.

[3] Lee *v.* Imbrie, 23 Or. 510.

[4] An early case in Mississippi is to the effect that persons admitted members of an *unincorporated banking company*, under the articles of association, are not liable for *tickets* issued before they became members. Lake *v.* Munford, 4 Smedes & M. (Miss.) 312.

[5] *Ante*, § 3076.

[6] *Ante*, § 3072.

[7] Chesley *v.* Pierce, 32 N. H. 388; Moss *v.* McCullough, 7 Barb. (N. Y.) 279.

§ 3178. Exception where the Liability is in the Nature of a Penalty for a Wrongful Act. — There is further ground for an exception to the rule, where the liability imposed by the statute upon the stockholders is in the nature of a penalty for the wrongful act or default of themselves, or the directors elected by them, in doing what is prohibited by statute, or in neglecting what is enjoined by statute; for it would be the height of injustice to visit the consequences of such wrong upon persons not in any sense in privity with it, and who could hardly be regarded as having any notice of it at the time of becoming members of the corporation. Thus, we find that there are, in some of the States, statutes making directors and shareholders personally liable for the debts of the corporation where its aggregate *indebtedness is suffered to exceed a given limit,* — as, three-fourths of its capital stock. These statutes are somewhat in the nature of a penalty for a wrong done to the public; they are, therefore, held to extend only to those who were directors and stockholders at the time the indebtedness was allowed to pass the prescribed limit; for the Legislature is assumed not to have intended to visit, for the past wrong-doing of others, a punishment upon such as happen to be members when suit by the creditor is brought.[1]

§ 3179. As for Contracting Debts before Stock Paid in. It also follows that under a statutory provision making stockholders liable to creditors until the whole amount of the capital is paid in, etc., a stockholder is not liable for debts contracted before he became a stockholder. A transfer of the stock does not operate as a transfer of the liability, nor can the creditor be deemed to trust persons who, when the credit is given, are not yet stockholders.[2] This conclusion may equally rest on either of the grounds stated in the two preced-

[1] Windham Prov. Ins. Co. *v.* Sprague, 43 Vt. 502.

[2] Tracy *v.* Yates, 18 Barb. (N. Y.) 152. *Contra,* that the stockholder in a manufacturing corporation, the capital stock of which has not been paid in, cannot escape liability for payments falling due after he became a stockholder, under a contract made before, see McMaster *v.* Davidson, 29 Hun (N. Y.), 542.

ing sections. If the statute is regarded as *leaving* the coadventurers liable as partners, and withholding from them the immunity of corporators until all the capital stock is paid in, then it is merely the application of the ordinary rule in respect of partners. If it is regarded as imposing a penalty upon the coadventurers for presuming to contract debts in the name of the corporation until the stock has been formed, which is the security of the creditors, then the conclusion merely refuses to visit the penalty upon those who are in no sense privies to the wrong. And so it has been held, construing a similar statute in Massachusetts, that, although a member of a manufacturing company may be liable for the debts of the corporation contracted while he was a member, although he ceases to be such before the debt became payable, yet he is not liable for debts contracted before he became a member if his membership expires before the debts become payable and action brought.[1] Another court reaches the same conclusion by reasoning that such a statutory liability is in the nature of a *contract* between the shareholders and creditors,— "a debt, under the statute,[2] due from the stockholders to the creditor, springing out of, and co-existent with, the contract between the corporation and the creditor."[3] This being so, it followed that no act of the stockholder, done without the consent of the creditor, could exonerate him from the liability thus incurred. The relation of stockholder is said to create a perfect legal obligation to pay the debts of the company until the whole capital shall have been paid in. Upon the faith of this obligation parties deal with the company. The liability of a stockholder, being, therefore, in the nature of a contract made between the company, the creditor, and himself, continues, and is in no manner affected by the transfer of his stock.[4]

§ 3180. Statutes under Which Liability Attaches to Those Who are Members at the Time the Liability is Sought to be Enforced. — But under other statutes and charters creating a

[1] Holyoke Bank *v.* Burnham, 11 Cush. (Mass.) 183.

[2] Md. Act 1852, ch. 338, § 9; Code Md., art. 26, § 52.

[3] Norris *v.* Wrenschall, 34 Md. 492.

[4] Hager *v.* Cleveland, 36 Md. 476; Matthews *v.* Albert, 24 Md. 527.

superadded individual liability, the construction is, that those stockholders are liable who are stockholders at the time *when the suit is brought to charge them.*[1] Under a statute of Massachusetts, making the members of manufacturing companies "jointly and severally liable for all debts and contracts made by such company *until the whole amount of such capital stock shall have been paid in,* and a certificate thereof shall have been made and recorded in the registry of deeds,"[2] it has been held that liability attaches to all who are members *at the time the liability is sought to be enforced,* and not merely to those who were members at the time the debt was contracted;[3] although it had been previously held, on the question of the competency of a witness under a similar statute, that liability attached to those who were such when the debt was contracted.[4] So, under a banking law of Wisconsin,[5] which provided that stockholders should be individually responsible to the amounts of their respective shares for all the indebtedness and liabilities of the association; that shares should be transferable, and that every person becoming a stockholder by such transfer should, in proportion to his shares, succeed to all the rights, and be subject to all the liabilities, of prior shareholders,—those who were shareholders at the time the suit in equity was commenced, on behalf of the creditors against the corporation and the shareholders, seeking to enforce their individual liability, were liable to respond under the statute, and not merely those who were such at the time when the debt was contracted. The statute affirmed the principle of the common law that, in the case of a transfer of any of the shares, the transferee succeeds to the rights and liabilities of his transferor.[6]

§ 3181. Statutes Fixing Liability upon Those Who were Stockholders at the Time when Payment Refused.—An early

[1] Root *v.* Sinnock, 120 Ill. 350; *s. c.* 24 Ill. App. 537.

[2] Mass. Stat. 1829, ch. 53, § 6; Rev. Stat. 1836, ch. 38, § 16.

[3] Curtis *v.* Harlow, 12 Met. (Mass.) 3.

[4] Mill Dam Foundry *v.* Hovey, 21 Pick. 417, 455.

[5] Wis. Rev. Stats. 1858, ch. 71.

[6] Cleveland *v.* Burnham, 55 Wis. 598.

bank charter of New Hampshire provided that if the corporation should refuse or neglect to pay their bills on demand, the original stockholders, their successors, assigns, and the members of the corporation, in their private capacities, should be liable to the holder. It was held by the Supreme Judicial Court of Massachusetts that liability under this charter attached only to such stockholders as were such *at the time when payment was refused.*[1]

§ 3182. At the Time of the Commencement of the Action against the Corporation. — Where the governing statute is such that the execution upon the judgment obtained against the corporation will run against the stockholders,[2] the principle of the preceding section would render those stockholders liable who were stockholders at the time when the action upon the debt or demand was commenced against the corporation; and so it has been held. An early statute of Massachusetts[3] enacted that whenever any execution should issue against any manufacturing corporation thereafter created, and such corporation should not, within fourteen days after demand made upon the president, treasurer, or clerk of such corporation by the officer holding the execution, show to him sufficient real or personal estate to satisfy and pay the sums due on such execution, the officer should serve and levy the same on the body or bodies, and real or personal estate or estates, of any member or members of such corporation. It will be observed that this statute was peculiar, in that it made shareholders liable as partners, and allowed executions against the corporation to run against them without any intermediate proceeding. It was held that the shareholders, whose estate and bodies might be thus taken in execution, were those who were such *at the time of the commencement of the action against the corporation,* and those only.[4] It was therefore held that if

[1] Bond *v.* Appleton, 8 Mass. 472; *s. c.* 5 Am. Dec. 111. Compare McDougald *v.* Bellamy, 18 Ga. 411.

[2] *Post,* §§ 3597, 3599.

[3] Stat. 1808, ch. 65, § 6.

[4] Child *v.* Coffin, 17 Mass. 64. Compare Marcy *v.* Clark, 17 Mass. 330, where it is *said* that the execution might be levied upon him who was a member *at the time of the levy.*

a shareholder *died* before the commencement of the action against the corporation, the execution could not be levied upon his estate, — a conclusion obvious upon any ground, unless there were some proceeding against his executor or administrator, which, in the particular case, was not had.[1] A statute of Maine, making stockholders, in general terms, liable for the debts of the corporation to the amount of their stock, has, in conformity with the general rule, been held to apply to those who were such at the time the judgment against the corporation was rendered, and who continued to be such until due proceedings to obtain satisfaction of the judgment had been had against the corporation without success, although they were not members at the time the debt was contracted.[2]

§ 3183. At the Time when Suit Brought to Charge Stockholders. — Under various statutes the courts fixed the liability to creditors upon those stockholders who are such at the time when the action is brought, in whatever form, to charge the stockholders. This rule coincides with what has already been stated with regard to past members.[3] Those who were members when the debts were contracted, and who remain such until suit is brought to charge them, are chargeable under principles already stated;[4] and those who were introduced by transfer, in the place of any who were such when the debt was contracted, became liable in their stead by substitution.[5] In conformity with what was stated at the beginning of this chapter,[6] the general rule therefore is, that those who are members at the time when proceedings are instituted to charge them, whether by a winding-up proceeding, or by a direct action at law or in equity, or under a statute, are liable.[7] Thus, it has been held that, under a provision of a bank charter that stockholders "shall be individually liable

[1] Child *v.* Coffin, 17 Mass. 64. Compare Powis *v.* Butler, 3 Com. B. (N. S.) 645; *post*, § 3319.

[2] Longley *v.* Little, 26 Me. 162.

[3] *Ante*, § 3171.

[4] *Ante*, § 3176.

[5] *Post*, § 3222.

[6] *Ante*, §§ 3170, 3180.

[7] Brown *v.* Hitchcock, 36 Ohio St. 676; Cleveland *v.* Burnham, 55 Wis. 598.

to the amount of their stock for the debts of the corporation," they are liable for the full amount of stock held by them at the commencement of the suit, whether paid up or not.[1] It is further held that in an action to enforce this liability, it need not affirmatively appear that defendant was a stockholder when the cause of action accrued; it is sufficient that he was stockholder when suit was brought.[2] Another court has held that the owners of the stock of an insolvent corporation, who are such *at the commencement of a creditor's suit* against its stockholders, to enforce their individual liability, are liable for its debts, though their stock may have been issued to them by the company after the creation of the debts.[3] So, a statute, which in general terms makes the persons and property of the members "at all times liable for the debts due" by the corporation, was held by a majority of the court to apply only to those who were members at the time the action to charge them is brought. A majority of the court also held that this liability did not attach to those who were members at the time the debt was contracted, but who had transferred their shares before the commencement of the suit against the corporation.[4] Under a charter of the same State, providing that "for all debts which may, at any time, be due from said company, the stockholders thereof shall be responsible in their private capacity, provided said corporation shall become insolvent," etc., liability attached to those who were stockholders when the debt was contracted, and also when the suit was commenced.[5]

§ 3184. At the Time of Suing Out Scire Facias for Execution against the Stockholder. — An English statute,[6] which doubtless has counterparts in this country, provided that "exe-

[1] Root *v.* Sinnock, 120 Ill. 350; *s. c.* 60 Am. Rep. 558; 11 N. E. Rep. 339; 8 West. Rep. 670.

[2] *Ibid.*

[3] Barrick *v.* Gifford, 47 Ohio St. 180; *s. c.* 21 Am. St. Rep. 798; 31 Am. & Eng. Corp. Cas. 484; 2 Am. Rail. & Corp. Rep. 690; 24 N. E. Rep. 259.

[4] Middletown Bank *v.* Magill, 5 Conn. 28. Compare Southmayd *v.* Russ, 3 Conn. 52; Curtis *v.* Harlow, 12 Met. 3.

[5] Deming *v.* Bull, 10 Conn. 409.

[6] 7 Geo. IV., ch. 46, § 13.

cution upon any judgment obtained against any public officer, for the time being, of any such corporation or copartnership carrying on the business of banking, under the provisions of this act, whether as plaintiff or defendant, may be issued against any member or members, *for the time being*, of such corporation or copartnership." This statute was construed according to its grammatical import. The words "for the time being" were held to refer to those who were such at the time of the act with reference to which the expression was used, — that is, at the time of suing out *scire facias* for an execution against individual members. This conclusion was strengthened by another clause of the statute, which, on failure of execution against the "members for the time being," authorized executions against *past members*, who were such when the debt was contracted; although, by some unaccountable slip, the Legislature had affixed no liability to members who were such when the debt was contracted, but who had ceased to be such before judgment obtained against the corporation, although they were such at the time the suit against the corporation was commenced.[1]

§ 3185. At the Time when Execution against Corporation Returned Nulla Bona. — A later English statute, — "the Companies Clauses Consolidation Act,"[2] — provided that "if any execution, either at law or in equity, shall have been issued against the property or effects of the company, and if there cannot be found sufficient whereon to levy such execution, then such execution may be issued against *any of the shareholders* to the extent of their shares, respectively, in the capital of the company not then paid up." The expression "any of the shareholders" was held to mean the persons who were shareholders at the time the execution against the property or effects of the company was found to be ineffectual.[3] A similar statute exists in Missouri, under which the Supreme

[1] Dodgson *v.* Scott, 2 Ex. 457; *s. c.* 6 Dowl. & L. 27; 5 Rail. Cas. 654; 12 Jur. 521; 17 L. J. Ex. 321.

[2] 8 & 9 Vict. ch. 16, § 36.

[3] Nixon *v.* Green, 11 Ex. 550; *s. c.* 25 L. J. Ex. 209; 3 Hurl. & N. 686; 27 L. J. Ex. 509.

Court of Missouri have held that in a proceeding thereunder by a judgment creditor of the corporation, by *motion* to obtain an execution against a stockholder, based upon a judgment, execution against the corporation, and a return of *nulla bona*,[1] liability attaches to the shareholder who was such *at the time the execution was sued out* against the corporation, and not to those who were stockholders at the time the debt was created, and who have since transferred their stock in good faith.[2] In adopting the English statute, the Legislature of Missouri was presumed, under a well-known rule, to have adopted with it the meaning placed upon it by the courts of the country first enacting it; and accordingly, following its English construction,[3] it was subsequently held that the liability of the stockholder is measured by the number of shares which he holds at the time of the *return of the execution* against the corporation, and not by the number which he holds at the time of the filing of the motion.[4] This was, of course, equivalent to holding that the liability attaches to those who are stockholders at the time of the return, *nulla bona*, of the execution against the corporation, at which date the liability of the stockholders to the creditor became fixed; and such is now the rule in that State.[5]

§ 3186. Assignee of Shares not Liable for Fraudulent Dividends Received by His Assignor. — Where there is a statute affirming the rule of the common law, under which a purchaser of shares succeeds to the rights and liabilities of his vendor in respect of them,[6] a transferee of shares does not become liable to restore a fraudulent dividend paid to his transferor. The meaning of the statute is, that the transferee shall succeed to all the rights, and be subjected to all the liabilities, incident to and growing out of his relation as a

[1] 1 Wag. Stat. 291, § 13.

[2] McClaren *v.* Franciscus, 43 Mo. 452.

[3] In Nixon *v.* Green, *supra.*

[4] Skrainka *v.* Allen, 76 Mo. 384; reversing, on this point, *s. c.* 7 Mo. App. 434, 441.

[5] Bagley *v.* Tyler, 43 Mo. App. 195, 204. Compare Miller *v.* Manion, 50 Mo. 55.

[6] Wis. Laws 1852, ch. 479; Wis. Rev. Stat., p. 600, § 22.

stockholder, in common with all other stockholders, but to such only as properly belong to the relation of stockholder.[1]

§ **3187. Effect of Renewals.** — Where, by the terms of the governing statute, or by construction, the shareholders are liable for no other than those debts which were contracted during the time when they held their shares, the question is likely to arise, At what time is a debt to be deemed to have been contracted, when it is evidenced by a note in renewal of a previous one? — in such a case, it has been held that each note given in *renewal* is to be regarded as a new contract and a *new debt.*[2] But this rule does not apply in the case of a note given for a previous *book account debt;* this is not the creating of a new debt, but the giving of a higher security for an existing debt; and, therefore, where the liability attaches to those who were shareholders at the time the debt was contracted, it is unnecessary for the declaration of a creditor, in an action at law against a shareholder, to state that the defendant was a shareholder when the note was given.[3]

[1] Hurlbut *v.* Tayler, 62 Wis. 607, 614.

[2] Castleman *v.* Holmes, 4 J. J. Marsh. (Ky.) 1; Milliken *v.* Whitehouse, 49 Me. 527. The same ruling has been made where the question arose with reference to the statute of limitations. Fisher *v.* Marvin, 47 Barb. (N. Y.) 159. On the question whether the giving of a new note in place of an old one creates a new debt, see Pryor *v.* Smith, 4 Bush (Ky.) 379; Kibbey *v.* Jones, 7 Bush (Ky.) 243; Ladd *v.* Dudley, 45 N. H. 61; McLaughlin *v.* Bank of Potomac, 7 How. (U. S.) 220, 228; Lowry *v.* Fisher, 2 Bush (Ky.),70; *s. c.* 92 Am. Dec. 475; Burns *v.* Thayer, 101 Mass. 426; Moore *v.* Beelman, 27 La. Ann. 276; Weymouth *v.* Sanborn, 43 N. H. 171; *s. c.* 80 Am. Dec. 144; Pratt *v.* Topeka Bank, 12 Kan. 570; Dillon *v.* Byrne, 5 Cal. 455; Birrell *v.* Schie, 9 Cal. 104; Austin *v.* Underwood, 37 Ill. 438, 441; *s. c.* 87 Am. Dec. 254; Wofford *v.* Gaines, 53 Ga. 485; Chase *v.* Abbott, 20 Iowa, 154; Harley *v.* Davis, 16 Minn. 487.

[3] Freeland *v.* McCullough, 1 Denio (N. Y.), 414, 426; *s. c.* 43 Am. Dec. 685. See this question in another relation, *ante,* § 3117; *post,* § 4086.

CHAPTER LVI.

STATUS AND LIABILITY OF LEGAL AND EQUITABLE OWNERS OF SHARES.

SECTION
3192. General rule.
3193. Legal owner liable.
3194. Trustees when liable personally.
3195. Statutes making the trust estate liable and exonerating the trustee.
3196. Trustees holding shares for the company.
3197. Trustee concealing his trust.
3198. Shares transferred to a person in trust without his knowledge or consent.
3199. Effect of trustee resigning his trust.
3200. Taking shares in name of fictitious trustee.
3201. Or in the name of any fictitious person.
3202. Or in the name of persons *non sui juris*.
3203. *Cestui que trust* not liable.
3204. Except in cases of fraud.
3205. Whether the nominee also put on the list.
3206. Assignees of insolvent estates.
3207. Whether assigned estate liable.
3208. Bankruptcy of shareholder.
3209. If company is wound up before bankruptcy.
3210. Whether discharge releases the bankrupt shareholder.
3211. Husband when liable for wife.
3212. Purchaser at execution sale of shares previously transferred.
3213. Whether pledgor or pledgee liable as a shareholder.
3214. Effect of company pledging its unissued shares.
3215. Further decisions on this question.
3216. Pledgee taking transfer in the name of an irresponsible party.

§ **3192. General Rule.**—The general rule is that the person *whose name rightfully*[1] *appears on the books of the corporation* is the shareholder, both as to the corporation and as to the public.[2] An extensive examination of the cases con-

[1] Simmons *v.* Hill, 96 Mo. 679; Chapman & Baker's case, L. R. 3 Eq. 360; Keyser *v.* Hitz, 133 U. S. 138; *ante*, § 1919; *post*, § 3193.

[2] State *v.* Ferris, 42 Conn. 560; Skowhegan Bank *v.* Cutler, 49 Me. 315; Matter of Empire City Bank, 19 N. Y. 199, 200; *s. c.* 6 Abb. Pr. (N. Y.) 385; Holyoke Bank *v.* Burnham, 11 Cush. (Mass.) 183; Crease *v.* Babcock, 10 Met. (Mass.) 525; Grew *v.* Breed, 10 Met. (Mass.) 569; Stanley *v.* Stanley, 26 Me. 191; Worrall *v.* Judson, 5 Barb. (N. Y.)

stantly brings us back to this idea, — an idea based on the most salutary considerations, which gives meaning and value to the registry of shareholders kept by the corporation, notifying creditors of the names which stand as guarantors of the corporate ventures, and of the extent of their several liability; and notifying shareholders of the names to whom they may look for contributions to the common burden.

§ 3193. **Legal Owner Liable.** — Unless the rule has been changed by statute, liability to pay calls and to respond, in the event of insolvency, to creditors, attaches to the holder of the *legal title* only; the courts will not look beyond the registered shareholder, nor inquire under what equities he holds. There are many illustrations of this, some of which have been separately considered. A., holding stock as a *trustee* for B., must himself pay the assessments or respond as a contributory, and look to B. for reimbursement.[1] A., holding the stock of B. as *collateral security*, if registered as the legal owner, is likewise held to the liabilities of a stockholder, and if he suffers a loss which B. ought to have suffered, that is a matter between him and B.[2] A. has *transferred* his shares to B., and B. has not caused the transfer to be registered. B.'s position is like that of a man holding land by a bond for a deed, — he is the equitable owner merely. A. is still the legal owner; he

210; Fowler *v.* Ludwig, 34 Me. 455; National Bank *v.* Case, 99 U. S. 628; Pullman *v.* Upton, 96 U. S. 328; Adderly *v.* Storm, 6 Hill (N. Y.), 624; Rosevelt *v.* Brown, 11 N. Y. 148; Magruder *v.* Colston, 44 Md. 349; *s. c.* 22 Am. Rep. 47; Wheelock *v.* Kost, 77 Ill. 296; Hale *v.* Walker, 31 Iowa, 344; Baines *v.* Babcock, 95 Cal. 581; *s. c.* 29 Am. St. Rep. 158; 30 Pac. Rep. 776; 27 Pac. Rep. 674; Baines *v.* Story (Cal.), 30 Pac. Rep. 777; following Baines *v.* Babcock, *supra;* Hawkins *v.* Glenn, 131 U. S. 319; Richmond *v.* Irons, 121 U. S. 27, 58; distinguishing Whitney *v.* Butler, 118 U. S. 655; Simmons *v.* Hill, 96 Mo. 679. A statute of Virginia affirms this rule in the following language: "Any person in whose name shares of stock stand on the books of the company shall be deemed the owner thereof as regards the company." Va. Code of 1873, ch. 57, § 27. As the rights of creditors against shareholders are derived through the corporation, this statute would, it may be supposed, create the same rule in their favor. See Hawkins *v.* Glenn, 131 U. S. 319, 335.

[1] *Post*, next section.

[2] *Post*, § 3213. See Franklin *v.* Neate, 13 Mees. & W. 481.

must pay assessments or respond to creditors, and look to B. for contribution.[1] A. has *mortgaged* his shares to B., and they still stand in the name of A. A bill in equity by the company to compel B. to pay calls upon them cannot be sustained.[2] A. transfers shares to B. upon a *trust* to secure C., who has made a loan of money to A., and B. dies insolvent. The company cannot compel C. to pay the arrears due on the shares.[3] This does not, however, necessarily exclude the idea that the equitable owner may be liable to creditors, should they elect to proceed against him; as, where stock was allotted to A. for B., at the request of the latter, who paid all the installments, but whose name did not appear on the books, he was chargeable by creditors for debts of the corporation.[4] In these last cases the equitable owner is the *real and full owner*, though without formal title.[5]

§ **3194. Trustees, when Liable Personally.** — This general rule is well illustrated by numerous cases where shares have been taken by one person in the name of another, to be held in trust for himself,[6] or where they are taken by a nominee of the company, to be held in trust for the company.[7] In either case the nominal holder or trustee in whose name the shares are registered is, in the event of a winding-up, put on the list of contributories. If he is injured by this, he must seek indemnity of his *cestui que trust*.[8] This supposes, of course, that the shares have been placed in the name of the trustee or nominee with his consent. If done without his consent, it

[1] *Post*, § 3284.

[2] Newry &c. R. Co. *v.* Moss, 14 Beav. 64.

[3] *Ibid.*

[4] Burr *v.* Wilcox, 22 N. Y. 551.

[5] *Post*, § 3200.

[6] Mitchell's case, L. R. 9 Eq. 336; Holt's case, 1 Sim. (N. S.) 389; Ind's case, L. R. 7 Ch. 485.

[7] Chapman & Barker's case, L. R. 3 Eq. 361; Hoare's case, 2 Johns. & H. 229; Ex parte Oriental Com. Bank, L. R. 3 Ch. 791; Hemming *v.* Maddick, L. R. 9 Eq. 175; *s. c.* L. R. 7 Ch. 395; Mitchell's case, L. R. 9 Eq. 363; Cree *v.* Somervail (H. L.), 4 App. Cas. 648; Preston *v.* Grand Collier Dock Co., 11 Sim. 327. Compare *post*, § 3196.

[8] Ex parte Oriental Com. Bank, L. R. 3 Ch. 791; Hemming *v.* Maddick, L. R. 9 Eq. 175; *s. c.* L. R. 7 Ch. 395; Stover *v.* Flack, 30 N. Y. 64; Muir *v.* Glasgow Bank (H. L.), 4 App. Cas. 337; Re Glasgow Bank, *Id.* 547; Cuninghame *v.* Glasgow Bank, *Id.* 607; Gillespie *v.* Glasgow Bank, *Id.* 632.

will not bind him, unless subsequently ratified.[1] **And if he be a** person incapable of consenting,—as an infant,—he is allowed a reasonable time to affirm or disaffirm after becoming *sui juris*.[2] It also supposes that there has been a completed transfer to the trustee or nominee.[3] There are, in some of the States, statutes which exempt executors, guardians, and other trustees of express trusts from personal liability on account of stock held by them in their fiduciary capacity. These statutes, however, have no application to such a case as arises where one person subscribes for stock in his own name in pursuance of a secret engagement to hold it, in whole or in part, for another.[4] Many distressing consequences of this principle followed the winding-up of the late City of Glasgow Bank. Many trustees had invested the trust funds in their hands in the shares of that great banking institution, and on its failure and winding-up they were put on the list of con-

[1] Chapman & Barker's case, L. R. 3 Eq. 366.

[2] *Post*, § 3271; Mitchell's case, L. R. 9 Eq. 363.

[3] Thus, a widow possessing shares in a joint-stock company, as representing her deceased husband, in whose name the shares stood, on the occasion of her second marriage assigned the shares by deed to a trustee for herself, but no transfer of the shares, according to the deed of settlement of the company, was ever made, and the shares continued to stand on the books of the company in the name of her deceased husband. The lord chancellor (Cottenham) refused to hold the trustee liable as a contributory, there being no other evidence to show that he had in any way connected himself with the company, except the circumstance that he had communicated to the company the fact of the deed of assignment, and had received dividends and signed receipts for the same on behalf of the widow, but never in terms as "trustee." Ex parte Hall, 1 Macn. & G. 307. See, in connection with this case, Hoare's case, 2 Johns. & H. 229. "One person may, if he pleases," said Lord Romilly, "become a trustee for another. He knows the consequences of so doing. He knows that he becomes personally liable for the calls, and that he is personally liable to be made a contributory. There are two sets of rights; one is as between himself and the person whom I may call the *cestui que trust*, and the other is as between himself and the company. As between himself and the company, he is a shareholder and a contributory, and cannot resist anything; but as between himself and the person for whose benefit he agreed to take them, he has a right over as against him; that is to say, he has a right to call upon him who is the real owner of the shares to make good any sums of money which he may have to pay for the calls, or for contributions, or for the like." Mitchell's case, L. R. 9 Eq. 366.

[4] Stover *v.* Flack, 30 N. Y. 64; *post*, § 3197, *et seq.*

tributories, and held to answer in their personal estates, and the circumstance that they were described as trustees in the register of shareholders was of no avail.[1] In the case of an *unlimited company* they stand, in common with all the other shareholders, under the joint and several liability of *partners*.[2] It is added by Sir Nathaniel Lindley, citing the cases in the margin: "Even if the trustee has not complied with all the formalities which ought to have been complied with according to the company's articles of association or deed of settlement, yet if the shares have been assigned to him, and he has accepted them, he will be a contributory in respect of them."[3]

§ 3195. Statutes Making the Trust Estate Liable, and Exonerating the Trustee.—Statutes have been enacted in various jurisdictions providing that no person holding shares as executor, administrator, guardian, or trustee shall be subject to any liabilities as a stockholder. Such statutes have existed in Massachusetts,[4] and in Rhode Island;[5] and such is one of the provisions of the act of Congress governing *national banks*.[6] Under these statutes it has been held that the trust property is answerable for the debts of the company in like manner as the property of the shareholder would have been if he had not held the shares in trust.[7] On a decree in a suit by a stockholder, who has had to pay debts of a corporation, brought under a statute of Massachusetts for contribution, against one who holds shares as guardian of minor children, the real estate of such of the wards as are minors *at the time*

[1] Muir *v.* Glasgow Bank, 4 App. Cas. 337; other cases, *Id.* 547; Cunninghame *v.* Glasgow Bank, *Id.* 607; Cree *v.* Somervail, *Id.* 648; Lumsden *v.* Buchanan, 4 Macq. 950.

[2] Gillespie *v.* Glasgow Bank, 4 App. Cas. 632. And see Davidson's case, 3 De Gex & S. 21; Ex parte Jones, 27 L. J. (Ch.) 666; Barrett's case, 4 De Gex, J. & S. 416.

[3] Lind. Comp., 5th ed., 801, citing Hoare's case, 2 Johns. & H. 229; Ex parte Drummond, 2 Giff. 189. Compare Ex parte Scully, 6 Ir. Ch. 72; Ex parte Hall, 1 Macn. & G. 307; reversing *s. c.* 3 De Gex & S. 80.

[4] Stedman *v.* Eveleth, 6 Met. (Mass.) 114; Mansur *v.* Pratt, 101 Mass. 60.

[5] Sayles *v.* Bates, 15 R. I. 342.

[6] Rev. Stats.,U.S., § 5152.

[7] Stedman *v.* Eveleth, *supra;* Sayles *v.* Bates, *supra.*

of the levy can be taken on execution against the stockholders, but not the real estate of such as have come of age before the decree.[1] Nor does the doctrine of the preceding section apply to trustees holding *national bank shares, where the trust is expressed* on the books of the association; since if he can be held to be, technically, a stockholder under the Revised Statutes of the United States, section 5151, he must be also held exempt from liability as trustee under section 5152.[2]

§ 3196. Trustees Holding Shares for the Company. — An exception to this rule of personal liability has been held to exist where the corporation, for purposes of its own, creates what is frequently called "*treasury stock*,"—that is, issues some of its shares, and places the certificates in the hands of its treasurer, to be by him sold for the benefit of the company. In such a case this officer assumes no personal liability to creditors.[3] But this conclusion ought to be accepted with caution. It can have no application except in cases where the transaction is *lawful;* and in such a case, of course, the trustee is entitled to be indemnified by the company against personal loss, just as any other trustee is entitled to be indemnified by his *cestui que trust* against losses which accrue to him from the lawful execution of the trust.[4] But if the transaction is unlawful, or *ultra vires*, or fraudulent, the rule is clearly different: the trustee will be held to his liability as a shareholder, while his right to indemnity may be repudiated.[5] Sir Nathaniel Lindley states that, under the old

[1] Mansur *v.* Pratt, *supra.*

[2] Welles *v.* Larrabee, 2 L. R. A. 471; *s. c.* 36 Fed. Rep. 866.

[3] An insurance company, authorized to commence business with a subscribed capital of $100,000, received subscriptions to the amount of $113,000, after which it received a subscription from A. of $12,000, as "treasurer in trust." It immediately thereafter organized and elected A. treasurer. The directors repeatedly recognized the subscription as having been made for the corporation. It was held that A. was not liable individually upon this subscription either to the company or its assignee in insolvency. Russell *v.* Bristol, 49 Conn. 251.

[4] James *v.* May, L. R. 6 H. L. 328; Ex parte Oriental Com. Bank, L. R. 3 Ch. 791.

[5] Ex parte Daniell, 1 De Gex & J. 372; *s. c.* 23 Beav. 568; Nickoll's case, 24 Beav. 639; Davidson's case, 3 De Gex & S. 21.

English winding-up acts, such a trustee would not be a contributory at all.[1] But he points out that, under the Companies Act 1862, members are contributories although they may be trustees for the company, and that their right of indemnity can only be taken into account when creditors have been paid, and the rights of the contributories *inter se* come to be adjusted.[2] The court will not "*rectify the register*," as it is called in that country, so as to take the name of the trustee off the register after the company has gone into liquidation.[3] On the other hand, if his name has never been on the register, and it is agreed between him and the company that it shall not be, the court will not put it there.[4]

§ **3197. Trustee Concealing His Trust.** — There are statutes and charters which authorize an investment of trust funds in corporate shares, with the proviso that the trustees shall not thereby become personally liable.[5] But in every such case the trust must, of course, be *expressed*, unless, possibly, in a case where the statute dispenses with this requirement. It may be assumed that in all cases one who takes as an original subscriber, or purchases and holds in his own name, and without any expression of trust on the books of the company, its shares, makes himself absolutely liable, and if he thereby suffers personal loss, must look to the trust estate for indemnity.[6] Thus, if a broker, purchasing shares for a customer, treats them as his own, he may be charged with the liability of a stockholder.[7]

§ **3198. Shares Transferred to a Person in Trust without His Knowledge or Consent.** — But, of course, one cannot be made a trustee without his consent, unless he has got the

[1] Citing Saunders's case, 2 De Gex, J. & S. 101.

[2] Lind. Comp., 5th ed., 804, 805; citing Chapman's case, L. R. 3 Eq. 361; Cree *v.* Somervail, 4 App. Cas. 648; Re Munster Bank, 17 L. R. Ir. 341; Re Ennis &c. R. Co., 3 L. R. Ir. 187.

[3] Cree *v.* Somervail, 4 App. Cas. 648.

[4] Gray's case, 1 Ch. Div. 664.

[5] *Ante*, § 3195.

[6] Ollesheimer *v.* Thompson Man. Co., 44 Mo. App. 172.

[7] McKim *v.* Glenn, 66 Md. 479.

property of another under such circumstances that a court of equity will charge him as a trustee in respect of it. Therefore, one to whom shares have been issued "as trustee," without his knowledge or consent, does not become a "*bona fide* stockholder" within the meaning of a statute prescribing the qualifications of electors at corporate elections;[1] nor will he become liable as a shareholder to creditors,[2] unless he ratifies the transfer by accepting the shares.[3]

§ **3199. Effect of Trustee Resigning his Trust.** — It is quite obvious that where the rule of liability is such that the trustee is personally liable so long as the shares stand on the books of the company in his name, and that the equities upon which he holds them are matters with which the company has nothing to do, he cannot determine this liability by the mere act of resigning his trust; he must go further, and transfer the shares, on the books of the company, out of his name and into the name of another, who may lawfully take them.[4] A substitution of trustees, made while the company is a going concern, and ending in a formal transfer of the shares on the books of the company to the new trustee, will, of course, terminate the liability of the retiring trustee.[5] But such a substitution of trustees, ending in a formal execution of a transfer from the retiring to the assuming trustee, will not be effectual to terminate the liability of the former where it is made after the corporation, by reason of insolvency, has ceased to be a going concern.[6]

§ **3200. Taking Shares in Name of Fictitious Trustee.** — Cases frequently occur where, for some reason peculiar to

[1] Stewart *v.* Mahoney Min. Co., 54 Cal. 149.

[2] Lind. Comp., 5th ed., 802; citing Pim's case, 3 De Gex & S. 11; *s. c.* 1 Macn. & G. 291; Hennessy's case, 3 De Gex & S. 191; *s. c.* 2 Macn. & G. 201.

[3] Ker's case, 4 App. Cas. 549, 598; Simmons *v.* Hill, 96 Mo. 679; Chapman & Baker's case, L. R. 3 Eq. 361; Keyser *v.* Hitz, 133 U. S. 138. Compare Bell's case, 4 App. Cas. 547.

[4] Mitchell's case (H. L.), 4 App. Cas. 548; Buchan's case, *Id.* 549; Ker's case, *Id.* 549.

[5] Bell's case (H. L.), 4 App. Cas. 547.

[6] Rutherfurd's case (H. L.), 4 App. Cas. 548.

their situation, persons take shares in companies in the names of other persons, under a private engagement that their nominees are to hold for them. Such arrangements are not necessarily fraudulent or objectionable on moral grounds. A Frenchman, for instance, would readily understand why a French nobleman, desiring to invest a portion of his income in shares of a joint-stock company, should take them in the name of his steward or bailiff. In the absence of fraudulent representations as to the condition in life of the nominee, such trusts are sustained, for reasons already given; but where the trust is merely fictitious, and especially where it is concocted to deceive the public, a court of equity is at liberty to hold the real beneficiary as a contributory.[1]

§ **3201. Or in the Name of any Fictitious Person.** — The subscribing for shares in the name of a fictitious or non-existent person is an obvious fraud upon the rights of creditors and other shareholders; since, if such a proceeding were sanctioned, it would result that there would always be a person ready to share the profits in the event of prosperity, but in the event of disaster, no one at hand to respond to creditors or to share the losses with honest shareholders. The courts defeat such roguish devices, by discovering the name of the real subscriber, and putting him on the list of contributories.[2]

§ **3202. Or in the Name of Persons Non Sui Juris.** — The same principle applies where a person, in order to evade liability as a shareholder while enjoying the benefits, takes shares in the name of a person incapable of contracting, — as an infant,[3] or a married woman.[4] As we shall see hereafter, the same principle applies, and is illustrated by a more numerous class of cases, where a shareholder, in order to escape liability, *transfers* his shares to a person insolvent or *non sui juris*.[5] But where a father applied for shares on the part of

[1] Cox's case, 4 De Gex, J. & S. 53. See *ante*, end of § 3193.

[2] Pugh & Sharman's case, L. R. 13 Eq. 566.

[3] Richardson's case, L. R. 19 Eq. 588.

[4] Pugh & Sharman's case, L. R. 13 Eq. 566.

[5] *Post*, § 3259, *et seq.*

his infant son, and paid the deposit, and the company refused to allow him to execute the deed on behalf of his son, and the father did no further act, he was held not liable as a contributory.[1] The governing principle of this and the preceding section is, that one who makes a contract in the name of a non-existent or incompetent person renders himself liable to perform the same, on the theory of *breach of warranty of agency.*[2]

§ 3203. Cestui que Trust not Liable. — The English rule on this subject is very weak in this, that if shares are taken by A. in the name of B., in order that A. may escape the responsibilities while enjoying the benefits of a shareholder, and B. authorizes, assents to, or ratifies this, B. will be held to be a contributory, and not A., — following the rule which looks only to the legal title; and this, although B. is insolvent, and A. is solvent.[3] It should seem that a court of justice might find a simple road, marked out by established principles, by which to avoid such a result, by looking through the substance of the transaction, and getting at the real owner, just as a court looks, when necessary, beyond the name of the obligor appearing on the face of the contract, and holds the undisclosed principal liable. But, as we shall elsewhere see,[4] the English courts proceed upon the view that such a transaction is good, if it is "*out-and-out,*" although it results in vesting the shares in a "*man of straw,*" who is introduced by the real owner in order that he may escape liability. The result is, that a shareholder, seeing that the venture is going to fail, can unload his shares upon an insolvent, even by giving them to him, if he parts with title "out-and-out," but not if the transfer is a "*sham,*" — that is, if he holds the shares by a string, so that he can pull them back if the venture again becomes promising. In other words, he can commit a

[1] Maxwell's case, 24 Beav. 321.

[2] *Ante,* § 417; *post,* § 3255.

[3] Bugg's case, 2 Drew. & S. 452. See also Fenwick's case, 1 De Gex & S. 557; Newry &c. Co. *v.* Moss, 14 Beav. 64; Wilson *v.* Keating, 27 Beav. 121; *s. c.* 4 De Gex & J. 588.

[4] *Post,* § 3256.

gross and intentional fraud, if he does it "out-and-out," but not if he does not do it "out-and-out."[1]

§ 3204. Except in Cases of Fraud.— The English courts profess to allow an exception to this rule in the case of actual fraud; but in this respect there is a wide divergence between their views and the views of the American courts as to *what is fraud.* In one case the promoter of a company took a number of shares, and placed them in the names of various persons, in order to deceive the public. The company failing, he was regarded as holding these shares for himself in the names of others, who were his mere nominees; and he was put on the list of contributories in respect of all of them.[2] So, where a man, desiring to be a shareholder in a certain company, without being one, procured a married woman to subscribe for shares for him, and they were allotted to her, it was held that he must go on the list of contributories.[3] So, where a father put shares in the name of his minor son, the father was put on the list, the son's name being treated as his.[4]

§ 3205. Whether the Nominee also Put on the List.— Whether the nominees of the fraudulent promoter, in the first case cited in the preceding section, would also be put on the list, was expressly left undecided. But there would seem to be no difficulty whatever on principle in dealing with such a question.[5] If a man enters into a contract for an *undisclosed principal,* the *obligee* may, at his election, hold him to the contract as made, or he may look beyond him, and hold the undisclosed principal. If one is solvent, and the

[1] Williams's case, 1 Ch. Div. 576; Mitchell's case, L. R. 9 Eq. 363; King's case, L. R. 6 Ch. 196; Chinnock's case, John. (Eng. Ch.) 714.

[2] Cox's case, 4 De Gex, J. & S. 53. Compare King's case, L. R. 6 Ch. 196.

[3] Pugh's case, L. R. 13 Eq. 566. Compare Re London &c. Bank, 18 Ch. Div. 581.

[4] Watson's case, L. R. 5 Ch. 614. See, also, Richardson's case, L. R. 19 Eq. 588. Compare Ex parte Scully, 6 Ired. Eq. 72.

[5] Consult, as to this, Barrett's case, 4 De Gex, J. & S. 416; Davidson's case, 3 De Gex & S. 21.

other is insolvent, he may take his choice; but he cannot hold *both*.[1] No reason is perceived why this principle should not enable a corporation or its creditors, or their representative, to look either to the name appearing on the books of the company, or to the name of the real party in interest, accordingly as their interest may appear.

§ **3206. Assignees of Insolvent Estates.** — It may be stated with confidence that the assignees of insolvent estates, a portion of whose assets consist of the shares of a corporation, do not become personally liable to the creditors of the corporation, unless they distinctly make themselves so by some act of their own, not required of them in the proper discharge of their official duties;[2] and it has been held that this is so, although the assignees attended the meetings of the corporation and acted as stockholders.[3] This holding has been cited with approval and followed by the Supreme Court of the United States in a case arising under the late bankrupt law, where the governing provisions of the act of incorporation were similar to those in the Massachusetts case.[4] The court say, citing the cases in the margin, that "it has long been a recognized principle of the bankrupt laws that the assignees were not bound to accept property of an onerous or unprofitable character."[5]

[1] Sessions *v.* Block, 40 Mo. App. 569; Priestly *v.* Fernie, 34 L. J. Ex. 172; Kendall *v.* Hamilton, 4 App. Cas. 504, 514; Kingsley *v.* Davis, 104 Mass. 178. Thus, if, after the principal is disclosed to him, he accepts in settlement the note of the agent, he thereby discharges the principal. Paige *v.* Stone, 10 Met. (Mass.) 160; *s. c.* 43 Am. Dec. 420; Ames Packing &c. Co. *v.* Tucker, 8 Mo. App. 95; Schepflin *v.* Dessar, 20 Mo. App. 569. "If he sues the agent and recovers judgment, he cannot afterwards sue the principal, even though the judgment does not result in the satisfaction of his debt." Lord Cairns, L. C., in Kendall *v.* Hamilton, *supra.*

[2] Gray *v.* Coffin, 9 Cush. (Mass.) 192; Bangs *v.* Lincoln, 10 Gray (Mass.), 600.

[3] Gray *v.* Coffin, 9 Cush. (Mass.) 192. The term "*trustee*" in the Massachusetts statute 1838, chapter 98, did not embrace "*assignees*" chosen under the insolvent law, statute 1838, chapter 163, subsequently enacted. *Ibid.*

[4] American File Co. *v.* Garrett, 110 U. S. 288, 295.

[5] South Staffordshire R. Co. *v.* Burnside, 5 Ex. 129; Furdoonjee's case, 3 Ch. Div. 264, 268; Ex parte Davis, 3 Ch. Div. 463; Streeter *v.* Sumner, 31 N. H. 542; Amory *v.* Lawrence, 3 Cliff. (U. S.) 523; Rugely *v.* Robinson, 19 Ala. 404. See *ante*, § 3122.

§ **3207. Whether Assigned Estate Liable.** — On principle, a personal liability to creditors of a corporation will follow the assigned estate of an insolvent member into the hands of his assignee, just as it will follow the estate of a deceased member into the hands of his personal representative.[1] But even this principle has been denied under the operation of a particular statute.[2]

§ **3208. Bankruptcy of Shareholder.** — Shares in a corporation, being property, of course pass by an assignment in bankruptcy, in common with other property of the debtor, although it may be otherwise as to shares in an unincorporated joint-stock company.[3] If calls are made on such shares while the company is a going concern, and it is necessary to pay them in order to save the shares from forfeiture, and it is to the interest of the bankrupt's estate that they should not be forfeited, it is presumed that the court of bankruptcy would, on a proper showing, direct the assignee to pay such calls.[4] A sale of such shares by the assignee in bankruptcy, under order of the court of bankruptcy, would, as a general

[1] *Post*, §§ 3318, 3320.

[2] For instance, it has been held that the qualified liability of a member of a manufacturing corporation for the debts of the corporation is not a *debt* within the Massachusetts law of 1838, chapter 163, that can be proved against the estate of the insolvent. Kelton *v.* Phillips, 3 Met. (Mass.) 61.

[3] A joint-stock company being nothing more than a partnership of many members (*ante*, § 14), if its organization is such that its *status* is that of a simple partnership, it is, of course, *dissolved* by the bankruptcy of one of its members. Greenshield's case, 5 De Gex & S. 599. The shares in such a company are not property, — do not pass as such under an assignment in bankruptcy, as do the shares in a corporation or a company formed under an act of Parliament; and hence the assignee in bankruptcy of a shareholder in such a company cannot, in the event of the winding up of the company, be made a contributory. *Ibid.*

[4] The official assignee of a bankrupt shareholder of a company paid out of the bankrupt's estate calls becoming due on the shares after the bankruptcy, and the creditor's assignees, in the usual course of business, signed *memoranda* vouching the accuracy of the official assignee's accounts, containing entries of the payments of the calls. The court held that this circumstance did not render the surviving creditor's assignee liable to be placed on the list of contributories in his own right as a member by survivorship. Stone's case, 3 De Gex & S. 220.

rule, on grounds hereafter stated,[1] terminate the liability of the bankrupt and of his estate, in respect of such shares. If the company is wound up pending the bankruptcy of a shareholder, and whilst the assignee in bankruptcy is the legal holder of the shares, the assignee will be put on the list of contributories in his representative capacity;[2] which means that the calls made on the bankrupt shareholder, in the proceeding to wind up the company, must be proved by the receiver or liquidator of the company in the court of bankruptcy, where he takes his dividend with other creditors of the bankrupt,[3] and subjects himself to the right of set-off, the same as any other creditor of the bankrupt.[4]

§ 3209. If Company is Wound Up before Bankruptcy.— It may, no doubt, be stated as a general conclusion that, if a company comes to an end before the bankruptcy of one of its shareholders, his certificate of discharge shields him from all liability to contribute to the debts of the company, and also to the expenses of winding it up.[5] This conclusion rests upon two reasons: 1. That the assignment in bankruptcy operates as a complete divestiture of the bankrupt's title to the shares, as fully as though he had transferred them *bona fide*, for a valuable consideration, to a person capable of taking them.[6] The bankrupt having thereby ceased to be a

[1] *Post*, ch. 57.

[2] Kuper's Assignee's case, 3 De Gex & S. 413.

[3] Re Duckworth, L. R. 2 Ch. 578, 581, *per* Lord Cairns, L. J.; Ex parte Pickering, L. R. 4 Ch. 58; Williams *v.* Harding, L. R. 1 H. L. 9; Ex parte Nicholas' Assignees, 2 De Gex, M. & G. 271. Under the English Companies Act, 1862, the company should be entered as a creditor, in the court of bankruptcy, for the estimated amount of future calls, as well as for calls already made. Ex parte Pickering, L. R. 4 Ch. 58.

[4] *Ibid.* Compare *post*, § 3785, *et seq.*

[5] Parbury's case, De Gex, F. & J. 80; Chapple's case, 5 De Gex & S. 400; Wylam's Steam Fuel Co. *v.* Street, 10 Ex. 849; Runnett *v.* Vináyak Pándurang, 9 Bombay H. C. Rep. 27, 31. See Warburg *v.* Tucker, 3 Macq. H. L. Cas. 772; Ex parte Harding, 33 L. J. (Bank) 26.

[6] The writer thinks that this has never been questioned in case of an American corporation; but under the present English Bankrupt Law (Bankruptcy Act, 1883, § 55) the trustee may disclaim the shares. Stat. 46 & 47 Vict., ch. 52, § 55. See Ex parte Clothworkers' Co., 21 Q. B. Div. 475; Ex parte Budden, 12 Ch. Div. 288; Ex parte Walton, 17 *Id.* 746; Levi *v.* Ayers, 3 App. Cas. 842; Hill *v.* East &c. Docks Co., 9 App. Cas. 448.

shareholder, of course ceases to be liable as such, unless there is a statute or rule of construction which makes him liable as a *past member*.[1] 2. That the sum which the shareholder was liable to contribute for the benefit of creditors was a debt provable in the proceeding in bankruptcy. If both or either of these reasons fail, the rule ceases.[2]

[1] *Ante*, § 3171.

[2] In South Staffordshire R. Co. *v.* Burnside, 5 Ex. 129, both of these conditions failed. The court ruled that there was no evidence of an acceptance of the shares by the assignee, and that the liability of the shareholder was not a debt provable under the then existing Bankrupt Act. 6 Geo. IV., ch. 16, §§ 51, 56. The court accordingly sustained an action of debt for calls, notwithstanding the shareholder's discharge in bankruptcy. The court reasoned that the legal title to the shares still remained in the bankrupt; and besides, "to make the bankrupt's estate pay a dividend on the full amount of the sum subscribed for, when no other shareholders were yet required, nor sure to be required, to pay a call, would put him in a worse situation than the others, and would be obviously unjust." In Financial Corporation *v.* Lawrence, L. R. 4 Com. P. 731, A., being a holder of shares in a company, executed an inspectorship deed. After the execution of this deed, a call was made on A.'s shares. Subsequently, but before the property included in the deed had been distributed among the creditors, the winding up of the company commenced. It was held that the call was not barred by the deed; the call was not provable in bankruptcy, —the liability was too uncertain (Mudge *v.* Rowan, L. R. 3 Ex. 85), —and, therefore, not a *debt* within the operation of the inspectorship deed. In Furdoonjee's case, 3 Ch. Div. 264, shares in an English company were taken by a resident at Bombay, who became insolvent. Afterwards, the company was ordered to be wound up. The debtor subsequently obtained an order of discharge under an Indian act. The Vice-Chancellor (Bacon) held that the liability of the insolvent, in respect of the shares, was not a debt provable in the insolvency proceedings, and hence that it was not barred by the order of discharge; and the name of the insolvent was ordered to be placed on the list of contributories. In General Discount Co. *v.* Stokes, 17 Com. B. (N. S.) 765, the liability of a shareholder for calls was held not to be a debt provable in bankruptcy. Under the English Bankruptcy Act of 1849, a certificate of discharge was, therefore, no bar to an action by a company against a shareholder for calls. Sir Nathaniel Lindley, in the last edition of his work on the Law of Companies, devotes a chapter to the subject of the effect of the bankruptcy of shareholders. Lind. Comp., 5th ed., 549, *et seq.* He points out that the distinctions above referred to have been abolished by the act of 1868, and also by the act of 1883, which is similar to it. Under this latter act, "when a shareholder becomes bankrupt, all calls in arrear are provable as debts, and his liability to future calls may be estimated and proved, as well when the company is being wound up, as when it is not. (See §§ 37, 55.) If the shares are neither disclaimed nor sold by the trustee, but are allowed

§ 3210. Whether Discharge Releases the Bankrupt Shareholder.—The authorities bearing upon this subject were gone into at some length by the court of appeal in chancery in Hastie's case;[1] and, keeping themselves within the limits of the case before them, the lords justices ruled that "a bankrupt must be retained as a contributory where the bankruptcy and the discharge precede the winding up, where the debt is not shown to be capable of valuation, where the assignees have repudiated the shares, and they have always remained, and still remain, vested in the bankrupt."[2] Sir Nathaniel Lindley states the present English law to be: "If a shareholder becomes bankrupt, calls made before his bankruptcy are provable against his estate; and under the Bankruptcy

to remain in the name of the bankrupt, and he obtains his discharge, it seems that he will nevertheless be freed from calls in respect of them, as his liability to them was capable of proof. Re Mercantile Mut. Ins. Asso., 25 Ch. Div. 415. Compare Furdoonjee's case, 3 Ch. Div. 264, which arose under an Indian insolvency act." Lind. Comp., 5th ed., 556.

[1] L. R. 4 Ch. 274.

[2] The court of Queen's bench has ruled that a shareholder in a company under the Companies Act, 1862, who has become bankrupt and received his discharge, but retains his shares, is not discharged from liability to pay subsequent calls, whether made while the company is in operation or when it is being wound up; for the covenant of the shareholder on becoming a member, under section 16, to pay the calls on his shares, is not "a contract to pay sums of money yearly, or otherwise," within section 154 of the Bankruptcy Act, 1861, so as to make the present value of their liability provable under that section; and section 75 of the Companies Act, 1862, which makes it "lawful, in the case of the bankruptcy of any contributory, to prove against his estate the estimated value of his liability to future calls," only applies where the bankruptcy of the contributory is contemporaneous with the winding up of the company. Martin's Patent Anchor Co. *v.* Morton, L. R. 3 Q. B. 306. It has been held in Massachusetts that the qualified liability of a member of a manufacturing corporation for the debts of the corporation, under the statute of 1808, chapter 65, section 6, was not a "debt" such as could be proved in a court of insolvency against the estate of a deceased shareholder, under a statute defining the demands which might be proved as "all *debts* due and payable from such debtor." Stat. 1838, ch. 163; Kelton *v.* Phillips, 3 Met. (Mass.) 61. The statute of 1808 made the members liable as original contractors, and execution ran against them on the judgments of the corporation, without their having any day in court. This ruling is of a piece with the ruling of the same court (*post*, § 3319) that the estate of a deceased shareholder, whilst enjoying the profits, could not be charged with liability under this statute.

Act of 1883[1] his liability to future calls is also provable. Therefore, his order of discharge is a bar to all calls, even though the trustee in bankruptcy may neither sell the shares nor disclaim them."[2]

§ **3211. Husband, when Liable for Wife.** — It has been laid down that where the common-law disabilities of married women have not been removed by statute, if a husband subscribes for shares in the name of his wife, and the corporation afterwards becomes insolvent, he will be liable as a shareholder to its creditors, although she may have a separate estate; and it has been so held, but with doubtful propriety, in a case where the husband purchased the shares for his wife under his statutory power as her trustee, and paid for them with moneys belonging to her separate estate, and caused certificates to be issued in her name,—his name not appearing on the books of the corporation as owner of the shares, in trust or otherwise.[3] A different conclusion was reached in a case before Vice-Chancellor Hall, in the English chancery division, where a husband subscribed for shares in the name of his wife, but without her knowing the fact, and afterwards transferred a part of them to a third person, but without her knowing of this transfer, and the attempt was to *rectify the register* so as to substitute his name (or that of his executor, he being dead) for hers. It was held that this could not be done, the Vice-Chancellor being of opinion that the object of the husband was to make a provision for his wife, and not to defraud the company, and the shares having been placed in her name with the consent of the directors. He added: "There is no case that I am aware of in which the register has been rectified where the name has been put upon the register deliberately by the company, without any fraud or concealment whatever."[4]

[1] 46 & 47 Vict., ch. 52, § 37.

[2] Lind. Comp., 5th ed., p. 426.

[3] National Commercial Bank *v.* McDonnell, 92 Ala. 387; *s. c.* 9 South. Rep. 149 (Clopton, J., dissenting.)

[4] Re London &c. Bank, 18 Ch. Div. 581; *s. c.* 50 L. J. Ch. 557; 30 Week. Rep. 118. The case did not touch at all on the question of the husband being liable at common law to per-

§ 3212. Purchaser at Execution Sale of Shares Previously Transferred. — It has been held that a purchaser, at a sale on execution, of shares which the judgment defendant has previously transferred in good faith *on the books* of the corporation as collateral security, acquires no title by such purchase so as to make him chargeable with liability as a stockholder to the creditors of the corporation. And this was so, although after making his purchase, he had demanded that his shares be transferred to him on the books of the company, and had brought an action against the company for damages upon its refusal so to do, which action he had, however, dismissed upon learning the facts; nor did he become liable because his name was afterwards placed on the books of the company as the holder of the shares without his knowledge or consent, he not having ratified the act, but having repudiated it when it did come to his knowledge.[1]

§ 3213. Whether Pledgor or Pledgee Liable as a Shareholder. — We have already seen that, as between the corporation and those claiming through it on the one hand, and its shareholders on the other, those are to be deemed shareholders, and liable as such to it, and to its creditors, who are holders of the *legal title*,—that is, whose names stand as shareholders, rightfully as between them and the corporation, on its books, without regard to any equities which may subsist between them and strangers.[2] Thus, if the shares continue to stand on the corporate books in the name of the pledgor, he, and not the pledgee, will be liable to credit-

form contracts made by him in the name of his wife, but was determined on the authority of two cases, where A. had purchased shares in good faith and placed them in the name of B., and was held not answerable in respect of them as a contributory. Williams's case, 1 Ch. Div. 576; King's case, L. R. 6 Ch. 196. Upon the point of what will amount to *consent* on the part of the wife, or to a *ratification* of the act of the husband in placing the shares in her name, see Keyser *v.* Hitz, 133 U. S. 138. Compare *ante*, § 2527, *et seq.*

[1] Simmons *v.* Hill, 96 Mo. 679; *s. c.* 10 S. W. Rep. 61; 2 L. R. A. 476.

[2] Re Empire City Bank, 8 Abb. Pr. (N. Y.) 192; *s. c.* 18 N. Y. 199; Holyoke Bank *v.* Burnham, 11 Cush. (Mass.) 183. See, also, Crease *v.* Babcock, 10 Met. (Mass.) 525; Grew *v.* Breed, 10 Met. (Mass.) 569.

ors, because he remains the owner of them.[1] On the other hand, "it is thoroughly established that one to whom stock has been transferred in pledge, or as collateral security for money loaned, and who appears on the books of the corporation as the owner of the stock, is liable as a stockholder for the benefit of creditors."[2] The reason why the courts so hold, briefly, is, that a man cannot become the legal owner of stock, receive dividends, vote at elections, and enjoy all other rights appertaining to the ownership of it, without shouldering the liabilities attaching to such a position. Another good reason is, that he will not be suffered to hold himself out to the public as the owner of stock, and afterwards deny that relation.[3] Besides, if creditors were compelled to look beyond the legal title, they could never know against whom to proceed, and it would embarrass them in the pursuit of their rights to compel them to inquire into equities which might exist between the stockholder and some third person.[4] Nor is it material that there is a statute providing that the term "stockholder" "shall apply, not only to such persons as appear by the books of the corporation or association to be such, but also to every equitable owner of stock, although the same may appear on such books in the name of another person"; for the person making the transfer is not the equitable owner in case of an hypothecation.[5] Although the debt for which the stock was hypoth-

[1] *Ante*, § 2619; Henkle *v.* Salem Man. Co., 39 Ohio St. 547; Beecher *v.* Wells Flouring Mill Co., 1 McCrary (U. S.), 62; Welles *v.* Larrabee, 2 La. Ann. 471; *s. c.* 36 Fed. Rep. 866.

[2] National Bank *v.* Case, 99 U. S. 628, 631; Simmons *v.* Hill, 96 Mo. 679, 685; *s. c.* 2 L. R. A. 476; 10 S. W. Rep. 61; Pullman *v.* Upton, 96 U. S. 328; Adderly *v.* Storm, 6 Hill (N. Y.), 624; Re Empire City Bank, 18 N. Y. 199; *s. c.* 8 Abb. Pr. (N. Y.) 192; Rosevelt *v.* Brown, 11 N. Y. 148; Holyoke Bank *v.* Burnham, 11 Cush. (Mass.) 183; Crease *v.* Babcock, 10 Met. (Mass.) 525; Grew *v.* Breed, 10 Met. (Mass.) 569; Wheelock *v.* Kost, 77 Ill. 296; Moore *v.* Jones, 3 Woods (U. S.), 53. A person who allows a transfer to be made to him, upon the books of a *national bank*, of shares of stock therein, even though such a transfer is made solely as security for a debt due the transferee, is liable as a shareholder under U. S. Rev. Stats., § 5139. Moore *v.* Jones, 3 Woods (U. S.), 53.

[3] Adderly *v.* Storm, 6 Hill (N. Y.), 624.

[4] *Ibid.*

[5] Re Empire City Bank, 18 N. Y. 223; *s. c.* 8 Abb. Pr. 192.

ecated has been paid, and a power of attorney has been given to retransfer it, if the retransfer has not been made on the books of the company at the time the creditor's rights attach, the pledgee will be chargeable as a stockholder.[1] But a retransfer divests the original transferee of all *future* liability, although the original transfer may have been in fraud of creditors.[2] But it has been held that a *savings bank*, holding as pledgee bank shares which it *has no right to own*, and appearing as owner on the books of the other bank, is not the owner of such shares, within the meaning of a statute relating to liability of owners of stock.[3]

§ 3214. Effect of Company Pledging its Unissued Shares. Assuming that a corporation or joint-stock company has the power to issue its unissued shares in pledge to secure a debt, what effect does this have upon the relation of the pledgee to the creditors of the company? Does he become charged with the general responsibilities of a shareholder? This question may doubtless be answered yes or no, according to surrounding circumstances. If the pledgee has been placed upon the register of the company as the absolute owner of a given number of shares, on which nothing has been paid, and he negligently suffers his name so to remain, manifestly he will be estopped, as against subsequent creditors, from denying that he is a shareholder.[4] Moreover, if he votes in respect of his shares at meetings of the company, and otherwise exercises in the affairs of the company the rights of a shareholder, a like estoppel will, on sound conceptions, arise against him;[5] though this has been denied, as we shall see.[6] A participation in the profits of the company would also have a tendency to fix upon him the liability of a shareholder.[7] But, in the absence of any circumstance of *estoppel* arising in favor of

[1] Adderly *v.* Storm, 6 Hill (N. Y.), 624.

[2] Holyoke Bank *v.* Burnham, 11 Cush. (Mass.) 183.

[3] Exchange Bank of Canada *v.* City &c. Sav. Bank, Montreal L. Rep. 6 Q. B. 196.

[4] *Ante*, § 1877, *et seq.*

[5] *Ante*, § 1901, *et seq.*

[6] Union Sav. Asso. *v.* Seligman, 92 Mo. 635; *s. c.* 1 Am. St. Rep. 776; *post*, § 3702.

[7] *Ante*, § 1909.

creditors, the pledgee will occupy the position in which the contract intended to place him, and he will not be liable as a shareholder.[1]

§ 3215. Further Decisions on this Question.—The question arose in Missouri, in several important cases, under the following statute: "No person holding stock in any such company, as executor, administrator, guardian, or trustee, and no person holding such stock as collateral security, shall be personally subject to any liability as stockholder of such company, but the person pledging such stock shall be considered as holding the same, and shall be liable as a stockholder accordingly; and the estates and funds in the hands of the executor, administrator, guardian, or trustee, shall be liable in like manner and to the same extent as the testator or intestate, or the ward or person interested in such fund, would have been, if he had been living and competent to act, and held the stock in his own name." This statute seems to be a counterpart of statutes which exist in Massachusetts, Rhode Island, and other jurisdictions, and which have been referred to in connection with the liability of *trustees* as stockholders.[2] With this statute in force, a Missouri railroad company, having a nominal capital of $10,000,000, desiring financial aid, solicited a loan of money from the well-known New York bankers, J. and W. Seligman. An agreement was made of the usual cut-throat character. The railroad company was to furnish the capital necessary to completely prepare the road for the iron, and to execute and deposit with the Seligmans its entire issue of first mortgage bonds, amounting to $5,000,000, together with a majority of the shares of its capital stock, the shares to remain in control of the Seligmans for one year at least; in consideration of which the Seligmans were to make certain advances in cash, from time to time, toward the completion of the road, the details of which advances are unim-

[1] Mathews *v.* Albert, 24 Md. 527; Union Sav. Asso. *v.* Seligman, *supra;* Ex parte Currie, 32 L. J. (Ch.) 57; McCracken *v.* McIntyre, 1 Duv. (Can.) 525; Ashworth *v.* Bristol, 15 L. T. (N. S.) 561.

[2] *Ante*, § 3195.

portant. The company, in pursuance of this agreement, executed a deed of trust of all its properties to secure the bonds thus deposited with the Seligmans, and, in pursuance of the agreement, and of an order of its board of directors, deposited with the Seligmans a certificate for 60,000 shares of its capital stock. The stock transfer book of the company, which it was required by law to keep, contained the list of its stockholders, and the stock issued to the Seligmans was entered therein as follows:

NAMES.	RESIDENCE.	DATE.	NO. OF SHARES.	AMOUNT IN DOLLARS.
J. & W. Seligman.	New York.	Dec. 20, 1872	60,000 Sixty thousand held in escrow.	$6,000,000 Six millions.

The Seligmans thus having acquired control of $6,000,000, in nominal amount, of the capital of the company, and of all its first mortgage bonds, voted the shares at two successive elections for directors of the company, and elected one of their own members a director. In short, they seemed to have taken possession of the company as fully, to all intents and purposes, as though they had originally organized it themselves. And yet, after some conflicting decisions, it was finally held that they were not liable as stockholders to one whose debt had been contracted so early that no element of *estoppel* could be asserted against them in his favor.[1] These decisions stand on the footing of decisions already noted.[2] They can be quoted in favor of the conclusion that, in the absence of an estoppel, corporate adventurers can do anything which they please with the shares, and the law will sanction their agreements. They can be quoted in favor of the doctrine that a man can be a stockholder and also a director without being a stockholder; that he can be a director for the mere purpose of securing himself as a creditor; and that he can take possession of a

[1] Burgess *v.* Seligman, 107 U. S. 20; Union Sav. Asso. *v.* Seligman, 92 Mo. 635; *s. c.* 1 Am. St. Rep. 776; 15 S. W. Rep. 630 (overruling Griswold *v.* Seligman, 72 Mo. 110, and reversing Union Sav. Asso. *v.* Seligman, 11 Mo. Ap. 142). Hough, C. J., and Sherwood, J., dissented.

[2] *Ante*, § 1665, *et seq.*

corporation and run it for his own benefit as a creditor without making himself liable to the other creditors for its debts, in the sense in which its ordinary shareholders would be liable. The books do not disclose a more thorough piece of financial thimble-rigging sanctioned by judicial decisions. The idea of any question of public policy entering into the disposition by a corporation of its unissued shares is totally obliterated by these decisions. The simple and proper interpretation of this Missouri statute would have been that it referred to ordinary contracts, well known among business men and of every-day occurrence, where shares of stock are issued as collateral security for money lent, and not to contracts where the lender makes himself a majority stockholder and a director, and assumes the entire management of the company, and manages it without paying its debts, and then escapes the personal liability of a stockholder in respect of them. That such, and such only, is its meaning is conclusively shown by the clause which provides that "the *person* pledging such stock shall be considered as holding the same, and shall be liable as a stockholder accordingly." How could the corporation pledging its own unissued shares be considered as the "person" here named? How could it be liable as a stockholder, holding its own shares? How can a creditor own his own debts while they still subsist as debts?[1]

§ 3216. Pledgee Taking Transfer in the Name of an Irresponsible Party. — It has been held by a majority of the Supreme Court of the United States, that a pledgee of shares of stock in a national bank, who, in good faith and with no fraudulent intent, takes the security for his benefit in the name of an irresponsible trustee, for the avowed purpose of avoiding individual liability as a shareholder, and who exercises none of the powers or rights of a stockholder, incurs no liability as such to creditors of the bank in case of its failure.[2]

[1] *Ante*, § 2054.

[2] Anderson *v.* Philadelphia Warehouse Co., 111 U. S. 479 (Miller and Matthews, JJ., dissenting).

CHAPTER LVII.

DIVESTITURE OF LIABILITY BY TRANSFERRING SHARES.

ART. I. IN GENERAL. §§ 3221–3228.
II. RIGHT OF SHAREHOLDER TO DIVEST HIS LIABILITY. §§ 3231–3250.
III. FRAUDULENT TRANSFERS TO ESCAPE LIABILITY. §§ 3255–3266.
IV. TRANSFERS TO PERSONS INCAPABLE OF CONTRACTING. §§ 3270–3279.
V. EXONERATION OF THE TRANSFEROR. §§ 3283–3297.
VI. LIABILITY OF THE TRANSFEREE. §§ 3301–3313.

ARTICLE I. IN GENERAL.

SECTION
3221. *Bona fide* transfer terminates liability of transferor.
3222. Transferee succeeds to rights and liabilities of transferor.
3223. Exception in favor of *bona fide* purchasers of shares which purport to be paid up.
3224. Contrary rule under exceptional charters and statutes.
3225. Exceptional rule in Pennsylvania.
3226. Exceptional rule in Ohio.
3227. Under Virginia code both transferor and transferee liable.
3228. Exception in case of liability for laborers' wages.

§ **3221. Bona Fide Transfer Terminates Liability of Transferor.** — The general rule is, that a *bona fide* transfer of shares, whether they be paid up or not, made in the prescribed manner on the books of the corporation, terminates the liability of the transferor, either to the company or to its creditors.[1] With this general principle in view, it has been

[1] *Ante*, § 1680; Chouteau Spring Co. *v.* Harris, 20 Mo. 382; Middletown Bank *v.* Magill, 5 Conn. 28, 68; Cole *v.* Ryan, 52 Barb. (N. Y.) 168; Cowles *v.* Cromwell, 25 Barb. 413; Miller *v.* Great Republic Ins. Co., 50 Mo. 55; McClaren *v.* Franciscus, 43 Mo. 452; Johnson *v.* Underhill, 52 N. Y. 203; Grissell *v.* Bristowe, L. R. 3 Com. P. 112; Huddersfield Canal Co. *v.* Buckley, 7 Term Rep. 36; Croxton's case, 1 De Gex, M. & G. 600; Sutton's case, 3 De Gex & S. 262; Mayhew's case, 5 De Gex, M. & G. 837; Allen *v.* Montgomery R. Co., 11 Ala. 437; Johnson *v.* Laflin, 5 Dill. (U. S.)

reasoned that where a member of a corporation objects to a transaction which is within its powers, he is still not exonerated individually for the debts consequent on it, unless he seasonably sells out or withdraws as a member.[1] So, stockholders of a *national bank* are liable to be assessed equally and ratably to the extent of their statutory liability for all debts existing while they hold stock and before they make a valid transfer of it.[2]

§ 3222. Transferee Succeeds to Rights and Liabilities of Transferor. — The transferee succeeds, not only to the rights, but also to the liabilities, of the transferor;[3] he is bound to pay the unpaid purchase-money of the shares as it shall be called for by the directors;[4] he is answerable in an action of *assumpsit*, or under the codes of procedure in an action of the like nature, for unpaid installments due thereon, the calls for which are made since the transfer;[5] and, in the event of the

65; *s. c.* 6 Cent. L. J. 124; *s. c.* affirmed, 103 U. S. 800; Jackson *v.* Sligo &c. Co., 1 Lea (Tenn.), 210; Merrimac Mining Co. *v.* Levy, 54 Pa. St. 227; *s. c.* 93 Am. Dec. 697; Billings *v.* Robinson, 94 N. Y. 415; Savage *v.* Putnam, 32 Barb. (N. Y.) 420; Tucker *v.* Gilman, 121 N. Y. 189; *s. c.* 30 N. Y. St. Rep. 689; 24 N. E. Rep. 302; Billings *v.* Robinson, 28 Hun (N. Y.), 122; Stewart *v.* Walla Walla Printing &c. Co. (Wash. Ter.), 20 Pac. Rep. 605. *Contra:* Moss *v.* Oakley, 2 Hill (N. Y.), 265; Bond *v.* Appleton, 8 Mass. 472; *s. c.* 5 Am. Dec. 111; Williams *v.* Hanna, 40 Ind. 535.

[1] Sumner *v.* Marcy, 3 Wood. & M. (U. S.) 105.

[2] Young *v.* Wempe, 46 Fed. Rep. 354.

[3] Hall *v.* United States Ins. Co., 5 Gill (Md.), 434; Hartford &c. R. Co. *v.* Boorman, 12 Conn. 538; Mann *v.* Currie, 2 Barb. (N. Y.) 294; Cowles *v.* Cromwell, 25 Barb. (N. Y.) 413; West Philadelphia Canal Co. *v.* Innes, 3 Whart. (Pa.) 198; Merrimac Min. Co. *v.* Bagley, 14 Mich. 501; Merrimac Min. Co. *v.* Levy, 54 Pa. St. 227; *s. c.* 93 Am. Dec. 697; Bend *v.* Susquehanna Bridge Co., 6 Har. & J. (Md.) 128; *s. c.* 14 Am. Dec. 261; Shickle *v.* Watts, 94 Mo. 410; Citizens' &c. Sav. Bank *v.* Gillespie, 115 Pa. St. 564; *s. c.* 9 Atl. Rep. 73; 7 Cent. Rep. 523; Bell's Appeal, 115 Pa. St. 88; *s. c.* 2 Am. St. Rep. 532.

[4] Ang. & A. Corp., § 534; Redf. on Rys., § 53; Hartford &c. R. Co. *v.* Boorman, 12 Conn. 530; Huddersfield Canal Co. *v.* Buckley, 7 Term Rep. 36. That the purchaser takes the shares *cum onere*, see Campbell *v.* American Xylonite Co., 3 N. Y. Supp. 822; *s. c.* 55 N. Y. Super. Ct. 562.

[5] Huddersfield Canal Co. *v.* Buckley, 7 Term Rep. 36; Bend *v.* Susquehanna Bridge Co., 6 Har. & J. (Md.) 128; *s. c.* 14 Am. Dec. 261; Webster *v.* Upton, 91 U. S. 65; Ang. & A. Corp., § 534; Hartford &c. R. Co. *v.* Boorman, 12 Conn. 530; Merrimac Min. Co. *v.* Bagley, 14 Mich. 501.

insolvency of the corporation, he is liable to contribute to the payment of its debts, in like manner as if he were an original subscriber,[1]—subject to exceptions in particular instances where the original subscribers are, notwithstanding, liable by charters or general statutory provisions.[2] The ground most usually taken by the courts in support of this conclusion is that when the transferee is accepted by the corporation, and the shares are transferred to him on its books, he *comes into privity* with the corporation, and, with its consent, takes the place and assumes the liabilities of the transferor, so that there is a species of *novation.*[3]

§ 3223. Exception in Favor of Bona Fide Purchasers of Shares Which Purport to be Paid Up. — As already seen,[4] an exception to the foregoing rules exists in favor of the *bona fide* purchaser of shares which are issued by the company as having been fully paid. A transferee of shares which purport on their face to be paid up, who takes them for value in the ordinary course of business, without notice of the fact that they are subject to future calls for any unpaid balance,

[1] Webster *v.* Upton, 91 U. S. 65; De Pass's case, 4 De Gex & J. 544; Cape's Executor's case, 2 De Gex, M. & G. 562; Mann *v.* Currie, 2 Barb. (N. Y.) 294; Bell's Appeal, 115 Pa. St. 88; *s. c.* 2 Am. St. Rep. 532.

[2] Bell's Appeal, *supra.*

[3] Webster *v.* Upton, 91 U. S. 65, where the doctrine is clearly stated by Mr. Justice Strong; Allen *v.* Montgomery R. Co., 11 Ala. 437, 451; Palmer *v.* Lawrence, 3 Sand. (N. Y.) 161. See, also, Cowles *v.* Cromwell, 25 Barb. (N. Y.) 413; Stewart *v.* Walla Walla Print. &c. Co. (Wash. Ter.), 20 Pac. Rep. 605; Upton *v.* Hansbrough, 3 Biss. (U. S.) 417. So, it has been held that if the unpaid portion of the *subscription* has been *secured by a mortgage,* and the president and directors accept a *new mortgage* from the transferee, this releases the transferor. Haynes *v.* Palmer, 13 La. Ann. 240. As hereafter stated (*post,* § 3225), there is an exceptional rule in Pennsylvania, but that court has applied the general rule of the above text in construing a Michigan statute. Merrimac Min. Co. *v.* Levy, 54 Pa. St. 227; *s. c.* 93 Am. Dec. 697; distinguishing Delaware &c. Canal Co. *v.* Sansom, 1 Binn. (Pa.) 70, and Palmer *v.* Ridge Min. Co., 34 Pa. St. 288. In Franks Oil Co. *v.* McCleary, 63 Pa. St. 317, 319, it is remarked that Merrimac Min. Co. *v.* Levy, *supra,* was decided on a Michigan charter, and that the court considered itself bound by the decisions of the supreme court of that State. That is true; but the case, nevertheless, is sound in all its expositions of law.

[4] *Ante,* § 1680, *et seq.*

is not liable for any unpaid balance which may, in fact, be due upon them.[1] The reason is that, the corporation having issued the shares, with a *representation* that they are paid up, or with what is tantamount to such a representation, no agreement can be implied, on the part of the prior holder or the corporation, that the prior holder is to make any further payment in respect of them.[2] The same rule has been held to obtain where the certificate is *silent* as to whether or not the shares have been fully paid for. In such a case it has been admitted that "the question is a perplexing one as to whether the purchaser of such shares is bound, at his peril, to make inquiry, or whether he is not protected by the want of notice."[3] The author has ventured[4] to doubt the propriety of a rule which puts it into the power of the managers of a corporation, by the simple device of issuing to the original nominees certificates where the shares have not been paid for, and allowing them to transfer the same to *bona fide* takers, to go before the public with the appearance of having a large paid-up capital, when, in fact, their capital is a mere shell.

§ 3224. Contrary Rule under Exceptional Charters and Statutes. — Charters and statutes have been enacted which by their terms create an exceptional rule under which the stockholder continues liable even after he has transferred his shares.[5] Thus, the provision of a Louisiana railroad charter, to the effect "that no transfer of stock shall exempt the party transferring it from the obligation of paying installments afterwards called for, until fifty per cent on each share shall have been paid," exempted from liability to the company only those who have transferred their share of stock after the payment of fifty per cent on each share, made before the install-

[1] West Nashville Planing Mill Co. *v.* Nashville Sav. Bank, 86 Tenn. 252; *s. c.* 6 Am. St. Rep. 835; Wintringham *v.* Rosenthal, 25 Hun (N.Y.), 580; Johnson *v.* Laflin, 5 Dill. (U. S.) 65. Compare Ross *v.* Kelly, 36 Minn. 38.

[2] West Nashville Planing Mill Co. *v.* Nashville Sav. Bank, 86 Tenn. 252; *s. c.* 6 Am. St. Rep. 835.

[3] West Nashville Planing Mill Co. *v.* Nashville Sav. Bank, *supra.*

[4] *Ante*, § 1682.

[5] Worrall *v.* Judson, 5 Barb. (N.Y.) 210; Mason *v.* Force, 30 Ga. 99.

ments had matured and payment had been demanded.[1] Such a provision was also found in the charter of an Illinois banking corporation, viz.: "Each stockholder shall be liable to double the amount of stock held or owned by him, and for three months after giving notice of transfers," etc. It was held that the intention of this act was to charge the stockholders with every debt made by the corporation while they held stock, and during three months after notice that they had transferred the same; and that actions against them were not barred because not brought within that period after they ceased to be stockholders.[2] Such, also, was the rule under the General Law of Pennsylvania of February 19, 1849, relating to railroad companies, the seventh section of which provided that no transfer should have the effect of discharging any of the liabilities incurred by the owners thereof.[3] And in general, if the *constitution of the company* provides that transferors shall continue liable for obligations of the company accruing prior to their transfer, they continue liable, accordingly, until the statute of limitations has run in their favor.[4]

§ **3225. Exceptional Rule in Pennsylvania.** — Not alone under the General Railroad Law of Pennsylvania alluded to in the preceding section, but as a general theory of law applicable to other corporations, it is held in that State that liability for unpaid installments of capital stock continues with the transferor, and is not shifted to the transferee so as to render him liable therefor, in the absence of a provision in the charter or governing statute making a different rule.[5] There are, however, cases in that State which recognize the common-law rule that the burden passes with the benefit. Such was the case in respect of the shareholders of a canal company specially chartered, where A., one of the subscribers, transferred his shares to B., and the latter, after installments had been called for, but before they

[1] Vicksburg &c. R. Co. *v.* McKeen, 14 La. Ann. 735.

[2] Hull *v.* Burtis, 90 Ill. 213.

[3] Some of the cases decided under this statute were the following: Pittsburgh &c. R. Co. *v.* Clarke, 29 Pa. St. 146; Graff *v.* Pittsburgh &c. R. Co., 31 *Id.* 489; Hays *v.* Pittsburgh &c. R. Co., 38 *Id.* 81; Cass *v.* Pittsburgh &c. R. Co., 80 *Id.* 31.

[4] Helby's case, L. R. 2 Eq. 167.

[5] Messersmith *v.* Sharon Sav. Bank, 96 Pa. St. 440; Palmer *v.* Ridge Mining Co., 34 Pa. St. 288.

were payable, transferred them to C., on the books of the company. C. agreed to the transfer before it was made, but never gave personal notice of acceptance nor called for the certificates. Here it was held that B. was not liable for installments due after the date of his transfer.[1]

§ 3226. Exceptional Rule in Ohio. — An exceptional rule was established in Ohio by the decision of a divided court, three judges against two. The question arose under the following constitutional provision and statute: "Dues from corporations shall be secured by such individual liability of the stockholders and other means as may be prescribed by law; but in all cases each stockholder shall be liable, over and above the stock by him or her owned, and any amount unpaid thereon, to a further sum at least equal in amount to such stock."[2] "All stockholders of any railroad, turnpike, or plank-road, magnetic telegraph, or bridge company, or any joint-stock company, organized under the provisions of this act, shall be deemed and held liable to an amount equal to their stock subscribed, in addition to said stock, for the purpose of securing the creditors of such company, and the trustees or directors of every society or association incorporated under section 66 of this act shall be deemed and held individually liable for all debts contracted by them for their respective societies or associations.[3] It is perceived that the constitutional provision is substantially similar to many existing in other States,[4] and that there is nothing in it which requires a peculiar construction. It is also perceived that the statute has two branches, — one relating to the liability of stockholders, and one to the liability of directors; that the part relating to the liability of stockholders does not specify for what particular debts, having regard to the date when contracted, the stockholders are to be held personally liable; while that relating to the liability of directors does provide that they shall be held "individually liable for all debts *contracted by them*," etc. The natural meaning of the clause relating to stockholders — and that would be in accordance with the interpretation placed by most other courts on similar statutes — would be, that those stockholders are individually liable who

[1] West Philadelphia Canal *v.* Innes, 3 Whart. (Pa.) 198. See, also, Re Glen Iron Works, 13 Phila. (Pa.) 479.

[2] Const. Ohio, art. 13, § 3.

[3] Swan & C. Ohio Stat., 310; 4 Curwen Ohio Stat., 2582.

[4] *Ante*, § 2998.

are stockholders at the time the corporation ceases to be a going concern.[1] This is the well-known rule with regard to *national banks*, where, as under the statutes of Ohio, the double liability is worked out through a proceeding in equity. But a majority of the Supreme Court of Ohio took the view that the liability imposed upon the stockholders (excluding that imposed upon the directors) attaches in favor of creditors against the stockholders who were such at the time when the debt was contracted or the liability incurred by the corporation. Having held so much, the conclusion naturally followed that a shareholder, who was such at the time the debt was contracted, could not discharge the liability by transferring his shares to another, — and this without reference to the question whether he was to be deemed a principal debtor or a surety or guarantor. The creditor has extended credit to the corporation on the faith of his being answerable for it if the corporation should fail to pay it. From a liability so fixed, even the Legislature could not release him, because that would impair the obligation of a contract;[2] and much less could he release himself by transferring his shares to another, whether that other were solvent or insolvent. A majority of the Ohio court, therefore, concluded that after such liability attaches, the stockholder is not discharged by the subsequent assignment or transfer of his shares; but the successive assignees or holders, by accepting the shares and the benefits arising from them, impliedly undertake to indemnify or discharge the assignor from the liability which has attached to him while holding them. Then followed two other correlative conclusions. One was, that in a suit by creditors to enforce such liability against the stockholders of an insolvent corporation, the existing stockholders are severally chargeable with the payment of such liability. The other was, that if, by reason of insolvency, the amount due from any stockholder is not collectible, the assignor of his shares, up to the time the liability attaches, may be charged with the insolvency.[3] These holdings prepared the way for the

[1] *Ante*, § 3170; *post*, § 3343.

[2] Hawthorne *v.* Calef, 2 Wall. (U. S.) 10; *ante*, § 3040.

[3] Brown *v.* Hitchcock, 36 Ohio St. 667. McIlvaine and Johnson, JJ. dissented. In their view — and this is the common view of such statutes — the liability attaches (saving, of course, the case of fraudulent conveyances of shares to escape liability, and other possible cases) only to those who were shareholders at the time of the commencement of proceedings to wind up the corporation and charge the stockholders. *Ante*, § 3060, *et seq.* The decision of the majority was fol-

decision of a question which arose in a subsequent case, which is thus formulated in the official syllabus: "A stockholder who, in good faith, sells and transfers his stock to one who afterwards becomes insolvent, is liable to creditors of the corporation for such portion only of the debts existing while he held the stock, and remaining due (not in excess of the amount of stock assigned), as will be equal to the proportion which the capital stock assigned by him bears to the entire capital stock held by solvent stockholders within the jurisdiction, liable, in respect of the same debts, to be ascertained at the time judgment is rendered."[1] It is thus seen that the interpretation which the Ohio court put upon their statute gives to a creditor, in case the shares have been transferred subsequently to the contracting of his debt, a *greater security* than he would have in case they had not been so transferred,—that is to say, the holder, at the time the proceedings are instituted to charge the stockholders, becomes primarily liable, as between himself and his transferor, in respect of such debt, though secondarily liable as between himself and the corporation; and that, if he cannot, by reason of insolvency, respond, his transferor, who was a stockholder when the debt was created, must respond. Such we understand to be the effect of the decision of that court in a case where, in a proceeding in equity to charge the stockholders of an insolvent corporation, the district court found that three of them were not owners of their shares at the time when the indebtedness to the plaintiff accrued, and thereupon gave judgment for them, holding that they were not liable to an assessment, as the other shareholders were. But the Supreme Court held that the finding that they were not owners of their shares at the time when the indebtedness of the corporation to the plaintiff accrued, did not authorize a judgment for them. "If the finding had been, that the stock they held when the action was commenced had not been sold by the corporation until after the debt of the plaintiff had accrued, the judgment

lowed after there had been a change in one of the five judges of the court, —Judge Spear having succeeded Judge Atherton,—and without any expressed dissent. Mason *v.* Alexander, 44 Ohio St. 318. This last case especially reaffirms the proposition of the former case, that if, by reason of insolvency or non-residence, the amount due from any stockholder is not collectible, the assignor of the stock up to the time the liability attached may be charged with the deficiency.

[1] Harbold *v.* Stobart, 46 Ohio St. 397; *s. c.* 15 Am. St. Rep. 618; 21 Ohio L. J. 407; *s. c.* 21 Cent. L. J. 110; 21 N. E. Rep. 637.

would have been proper. If the stock held by these defendants had, before the debt accrued to the plaintiff, been sold by the corporation, and they afterwards became the owners of it, they would be primarily liable to the creditors of the corporation."[1] It is also perceived that the interpretation thus put by the Ohio court upon their constitutional provision and statute imposes on the stockholders, who are such at the time of the suspension of the corporation, a more onerous liability than that which is held to rest upon stockholders in national banks, in this particular, — that each stockholder's ratable contribution is stated upon the basis of the solvent stockholders, thus making the solvent answer for the insolvent; whereas, the contrary is the rule under the National Banking Act.[2]

§ 3227. Under Virginia Code Both Transferor and Transferee Liable. — By the code of Virginia it is provided that "no stock shall be assigned on the books without the consent of the company, until all the money which has become payable thereon has been paid; and on any assignment the assignee and assignor shall each be liable for any installment which may have accrued, or which may thereafter accrue."[3] The same statute also provides that "a person in whose name shares of stock stand on the books of a company shall be deemed the owner thereof, as regards the company."[4] Under this statute a transferor or assignor of shares of stock is still liable for unpaid subscriptions, whether the installments accrue before or after the assignment.[5] Under it one who purchases stock in his own name, although merely as a broker, and immediately assigns it, continues liable for future, as well as past, assessments upon the stock, though the assignee becomes liable also.[6] Although the statute makes both the assignor and the assignee of corporate stock liable for unpaid subscriptions, a *release* of one does not necessarily discharge the other, the liability being *several* and not joint.[7] Moreover, under this statute the implied obligation on the part of an assignee of such stock to *indem-*

[1] Bonewitz *v.* Van Wert County Bank, 41 Ohio St. 78.

[2] Rev. Stats. U. S., § 5151; *ante*, § 294. Compare *post*, § 3430, *et seq.*

[3] Va. code 1860, ch. 57, § 24.

[4] *Ibid.*, § 25.

[5] Hamilton *v.* Glenn, 85 Va. 901; 9 S. E. Rep. 129; *s. c.* 13 Va. L. J. 242; McKim *v.* Glenn, 66 Md. 479; Hawkins *v.* Glenn, 131 U. S. 319; Glenn *v.* Priest, 48 Fed. Rep. 19.

[6] McKim *v.* Glenn, 66 Md. 479; *s. c.* 8 Atl. Rep. 130.

[7] Glenn *v.* Foote, 36 Fed. Rep. 824; *s. c.* 5 Rail. & Corp. L. J. 136.

nify his immediate assignor against calls subsequently made, which the assignor is compelled to pay, exists only where the assignee is the holder of the stock at the time the call is made; it does not extend to calls made subsequently to a transfer of the stock by such assignee to others.[1]

§ 3228. Exception in Case of Liability for Laborers' Wages. — Another exception has been declared under a statute such as we have already had occasion to consider,[2] making shareholders liable for the wages of servants, laborers, etc. It has been held that this liability, once fixed, cannot be divested by the shareholders who were such at the time when the indebtedness accrued, by transferring their shares, although such transfer may have taken place before the bringing of the action to charge the shareholder individually. The reason is that the statute makes the wages, when they are once earned, a binding obligation on the part of the shareholders, and this cannot be shifted from their shoulders without the consent of the other party to the contract.[3]

ARTICLE II. RIGHT OF SHAREHOLDER TO DIVEST HIS LIABILITY.

SECTION
3231. Right to transfer shares.
3232. No implied power to restrain alienation of shares.
3233. By-laws restraining transfers of shares void.
3234. Valid only so far as necessary to protect rights of corporation.
3235. Distinction between by-law and charter provision restraining such alienation.
3236. How as to national banks.
3237. Restraining transfers.
3238. By-laws prohibiting transfers while transferor indebted to corporation.
3239. Interpretation of such regulations.
3340. Not retroactive.
3241. When purchaser of shares chargeable with notice of such a by-law.
3242. When transfers require approval of directors.
3243. Usage that stock not transferable where holder indebted to company.
3244. Effect of certificate transferable on its face.
3245. Power to impose such restraint in the certificate.

[1] Brinkley *v.* Hambleton, 67 Md. 169; *s. c.* 8 Atl. Rep. 905; 10 East. Rep. 694.

[2] *Ante*, § 3146, *et seq.*

[3] Jackson *v.* Meek, 87 Tenn. 69; *s. c.* 10 Am. St. Rep. 620, 622.

SECTION
3246. Statutory lien of a corporation upon its shares.
3247. Lien created by articles of incorporation.
3248. Effect and extent of such lien.
SECTION
3249. Effect of such a lien upon indorsers and sureties.
3250. Waiver of this lien by the corporation.

§ **3231. Right to Transfer Shares.**— The leading difference between a corporation or joint-stock company and a simple partnership discovers itself in the fact that the members of the former may freely transfer their shares to strangers, introducing the latter in their stead;[1] whereas, if a member of a simple partnership sells out his interest, this amounts to a dissolution of the firm.[2] Shares of stock in a corporation are personal property.[3] The *jus disponendi* is essential to the very notion of property. The general rule, subject to qualifications growing out of the peculiar nature of the property, and others founded in the governing statute or constitution of the company, is, that a shareholder may freely transfer his shares to any other person capable of making or taking a a contract, thus introducing the latter as a member of the corporation in his stead.[4]

[1] *Ante*, § 2300, *et seq.*; Allen *v.* Montgomery R. Co., 11 Ala. 437, 451; Overseers *v.* Sears, 22 Pick. (Mass.) 122, 131; Cole *v.* Ryan, 52 Barb. (N. Y.) 168; Brightwell *v.* Mallory, 10 Yerg. (Tenn.) 196; Weston's case, L. R. 4 Ch. 20; Johnson *v.* Laflin, 5 Dill. (U. S.) 75; *s. c.* 6 Cent. L. J. 124; Gilbert's case, L. R. 5 Ch. 559. See Bank of Attica *v.* Manufacturers' &c. Bank, 20 N. Y. 501.

[2] Middletown Bank *v.* Magill, 5 Conn. 28, 68. On the subject of the right of *lien* of a corporation upon its shares, see *ante*, § 2317; also 11 Am. Dec. 581, note.

[3] *Ante*, § 1066.

[4] Bank of Attica *v.* Manufacturers' &c. Bank, 20 N. Y. 501; Bent *v.* Hart, 10 Mo. App. 143, 147; Waltham Bank *v.* Waltham, 10 Met. (Mass.) 334; Hutchins *v.* State Bank, 12 Met. (Mass.) 421; Wheelock *v.* Moulton, 15 Vt. 519; Isham *v.* Bennington Iron Co., 19 Vt. 230; Arnold *v.* Ruggles, 1 R. I. 165; Denton *v.* Livingston, 9 Johns. (N. Y.) 96; 6 Am. Dec. 264; Gilpin *v.* Howell, 5 Pa. St. 41; *s. c.* 45 Am. Dec. 720; Slaymaker *v.* Bank of Gettysburg, 10 Pa. St. 373; State *v.* Franklin Bank, 10 Ohio, 91; Johns *v.* Johns, 1 Ohio St. 350; Heart *v.* State Bank, 2 Dev. Eq. (N. C.) 111; Planters' & Merchants' Bank *v.* Leavens, 4 Ala. 753; Union Bank *v.* State, 9 Yerg. (Tenn.) 490; Brightwell *v.* Mallory, 10 Yerg. (Tenn.) 196. For an *illustrative case* turning upon the question of this right, see Bent *v.* Hart, 10 Mo. App. 143.

§ 3232. No Implied Power to Restrain Alienation of Shares. — It follows that a corporation cannot restrain one of its members from transferring his shares, unless the Legislature has given it power so to do, or unless the members themselves have clothed it with such power in the by-laws or other governing instrument. In England this power may be exercised by the corporation, through its directors or other officers, where it is given by the deed of settlement or other constating instrument; but an American court has gone so far as to hold that a by-law of a bank prohibiting the transfer of its stock is void as in restraint of trade.[1] But it would, no doubt, be competent, in the absence of any element of *estoppel* in favor of creditors, for all the members of a corporation to agree that no member should be permitted to withdraw from the concern without consent of the others, for this would be nothing more than to assume, by universal consent, one of the incidents of a partnership. But it has been held that the power to *regulate* the transfer of shares, conferred by the *by-laws* of a corporation upon its directors, does not enable them to *restrain* such transfers altogether, even to an insolvent.[2] It may be laid down as entirely clear that if the corporation has no *lien* upon or *interest* in the shares at the time when the attempted transfer is made, such transfer is good between the parties, and the company cannot rightfully object to the same or refuse to register the same on its books.[3]

§ 3233. By-laws Restraining Transfers of Shares Void. — The right of alienation being an incident of property, a *by-law* of a bank prohibiting the alienation of its stock, or putting restrictions thereon, has been held void, as being *in restraint of trade*.[4] This is in accordance with the doctrine

[1] Moore *v.* Bank of Commerce, 52 Mo. 377.

[2] Chouteau Spring Co. *v.* Harris, 20 Mo. 382. See, also, Driscoll *v.* West Bradley Man. Co., 36 N. Y. Sup. Ct. 488; *ante*, §§ 1028, 1032.

[3] People *v.* Crockett, 9 Cal. 112. For a learned note on the subject of the power of corporations to prohibit transfers of their shares, with the citation of many cases, chiefly English, see 15 Am. & Eng. Corp. Cas. 574.

[4] Moore *v.* Bank of Commerce, 52 Mo. 377; *ante*, § 1028.

laid down by the English Court of Appeal in Chancery, reversing Lord Romilly, M. R. It was there held that the directors of a company have no discretionary power, independently of powers expressly given them by the articles of association, to refuse to register a transfer which has been *bona fide* made. Therefore, where a transferee gave an address at which he was only an occasional visitor, it was held that the directors were bound to register the transfer, although the company was at the time in difficulties, and the shares were sold by the transferor in order to get rid of his liabilities.[1] So, a *by-law* which required the consent of all the stockholders to a transfer of the shares of a member has been held void as *against public policy*, even where the stockholders were originally copartners, and the one attempting to transfer his stock voted for such by-law.[2]

§ 3234. Valid Only so Far as Necessary to Protect Rights of Corporation. — Other courts hold that *by-laws* of corporations restraining the transfer of shares are only valid in so far as they operate to protect the rights of the corporation in respect of the shares; they are not valid where they merely interfere with the rights of third persons.[3] When, therefore, the president of a bank, who was a *surety* upon the note of an insolvent stockholder to a third person, took an *assignment* of the stock of such stockholder for his indemnity, and the stockholder was at the time also indebted to the bank,—it was held that as the corporation had no express lien upon the shares

[1] Weston's case, L. R. 4 Ch. 20.

[2] In re Klaus, 67 Wis. 401; *s. c.* 29 N. W. Rep. 582; 26 Am. L. Reg. (N. S.) 98. See, also, as to national banks, Feckheimer *v.* National Exch. Bank, 79 Va. 80. But see *ante*, § 1032. For stronger reasons a mere *rule* of the board of directors of a corporation prohibiting the transfer of shares by its members when they are indebted to the corporation, which rule does not have in law the effect of a by-law, and is not filed as such with the Secretary of State, as is required by statute, and which is, moreover, unknown to the purchaser of shares, is not binding upon him; and notwithstanding such rule, if the corporation refuses to transfer on its books shares which he has purchased, he may maintain an action against them for the *damages*. Carroll *v.* Mullanphy Sav. Bank, 8 Mo. App. 249, 254.

[3] Farmers' &c. Bank *v.* Wasson, 48 Iowa, 336; *s. c.* 30 Am. Rep. 398.

of the insolvent, and as the law gives no implied lien, the directors could not rightfully, under such a by-law, withhold their consent to the transfer, and that the transferee took an equitable title.[1]

§ **3235. Distinction between By-law and Charter Provision Restraining such Alienation.** — Somewhat in accordance with this theory, a *distinction* has been taken between a restraint imposed upon the alienation of shares by a *by-law*, and such a restraint imposed by the *charter* or governing *statute* of the corporation,— with the conclusion that where the restraint is imposed by a by-law merely, this is to be allowed an operation no further than is necessary to protect the rights of the corporation, leaving the transfer good as between the transferor and the transferee; but that where it is prohibited by the charter or governing statute under conditions named, that prohibition renders the transfer void even as between the parties to it.[2] But whether this distinction is well founded may be doubted, in view of the fact that statutes and charter provisions prohibiting, expressly or impliedly, the transfer of shares, except upon the books of the corporation, are generally construed as enacted to protect the rights of the corporation merely, to prevent such a transfer from being good as against it, while leaving it good as between the parties to it.[3]

§ **3236. How as to National Banks.** — Although two State decisions may be quoted in favor of the proposition that it is competent for a *national banking association* to make a by-law restraining the transfer of shares, without the assent of the directors, so long as the stockholder is indebted to the bank,[4] and although by the express language of the governing statute "every person becoming a shareholder by such transfer shall, in proportion to his shares, succeed to all the rights

[1] Farmers' &c. Bank *v.* Wasson, 48 Iowa, 336; *s. c.* 30 Am. Rep. 398.

[2] O'Brien *v.* Cummings, 13 Mo. App. 197, 198.

[3] *Ante*, § 2389.

[4] Lockwood *v.* Mechanics' Nat. Bank, 9 R. I. 308; *s. c.* 11 Am. Rep. 253; Young *v.* Vough, 23 N. J. Eq. 325.

and liabilities of the prior holder of such shares,"[1] — yet it is settled that no power exists in such a corporation, either in its *articles of association* or in its *by-laws*, to impose a lien upon the shares of its stockholders to secure an indebtedness to itself.[2] It has been held that such a *by-law* is *void*, in so far as it intends to secure the bank by a lien upon the shares of one of its stockholders for a loan made to him, as being in contravention of that section of the statute[3] which prohibits such banks from making loans on the security of their own stock.[4]

§ 3237. Restraining Transfers when Shareholders Indebted to Corporation. — Every corporation has power, within the limits prescribed by its charter and by the general law, to make regulations prohibiting the transfer of shares by members who stand indebted to the corporation. Such regulations amount to nothing more than the assertion of a species of lien upon the shares in favor of the corporation,[5] and the refusal of the corporation to accept the credit of *some one else*— it may be an irresponsible person—for the credit which was accepted when the transferor's subscription was received and the shares were issued to him. It is no sound argument against this conclusion, that such regulations are not in harmony with the general laws of the State regulating the transfer of personal property.[6] This conclusion is imperatively required by the reason, upon which alone it is possible to uphold the doctrine, that the liability for the unpaid balance of a share subscription *follows the shares*.[7] That reason is that there is a species of *novation* resulting from the concurrent consent of the transferor, the transferee, *and the corporation.* But the reason totally fails if the corporation is incapable of withholding its consent.

[1] Rev. Stats. U.S., § 5139.

[2] *Ante*, § 2319.

[3] Rev. Stats. U.S., § 5201.

[4] Feckheimer *v.* National Exch. Bank, 79 Va. 80.

[5] St. Louis Perpetual Ins. Co. *v.* Goodfellow, 9 Mo. 149; Kahn *v.* Bank of St. Joseph, 70 Mo. 262; Mechanics' Bank *v.* Merchants' Bank, 45 Mo. 513; *s. c.* 100 Am. Dec. 388.

[6] St. Louis Perpetual Ins. Co. *v.* Goodfellow, *supra;* Mechanics' Bank *v.* Merchants' Bank, *supra.*

[7] *Ante*, § 3222.

§ 3238. By-laws Prohibiting Transfers while Transferor Indebted to Corporation. — These are, therefore, generally upheld as valid;[1] but whether they are so or not would seem to depend upon the question whether the corporation has power, under its charter, to make such a by-law. Cases are found which hold that the corporation has this power; but the conclusion of the court seems to have been influenced by the language of particular statutes or charters.[2] By-laws have been upheld providing that if any member becomes indebted to the company, his stock shall be *liable for the debt.*[3] A *charter provision* that the stock shall be *assignable on the books of the bank,* under such regulations as the trustees shall establish, is held to authorize a by-law that "no stockholder shall be permitted to transfer his stock while in default."[4] Under a similar charter provision, a by-law has been upheld prohibiting any transfer of stock in the company by a person indebted to it, where the certificates of stock stated that the stock was transferable on the books of the company only in conformity to the charter and by-laws.[5] A power conferred by the charter to make *rules* concerning the transfer of stock, and *also* to make *by-laws,* has been held to extend to the making of a by-law that no stockholder shall sell his stock while indebted to the company.[6] So, it was held that a corporation, organized under a statute which authorizes it to make by-laws for "the management of its property, the regulation of its affairs," and "the transfer of its stock," and which further provides that the stock of the company "shall be transferable in such manner

[1] *Ante*, § 2321.

[2] Weston *v.* Bear River &c. Co., 5 Cal. 186, 189; *s. c.* 63 Am. Dec. 117; People *v.* Crockett, 9 Cal. 112, 115; as explained in Pendergast *v.* Bank, 2 Saw. (U. S.) 108, 116.

[3] Child *v.* Hudson's Bay Co., 2 P. Wms. 207. In 'assignees of Morgan *v.* Bank of North America, 8 Serg. & R. (Pa.) 73, 89; *s. c.* 11 Am. Dec. 575, the court speak of the doctrine of this case as the recognized law.

[4] Cunningham *v.* Alabama Life Ins. Co., 4 Ala. 652.

[5] St. Louis &c. Ins. Co. *v.* Goodfellow, 9 Mo. 149. See, also, Brent *v.* Bank of Washington, 10 Pet. (U. S.) 596, 615.

[6] M'Dowell *v.* Bank of Wilmington, 1 Harr. (Del.) 27; Leggett *v.* Bank of Sing Sing, 24 N. Y. 283; Vansands *v.* Middlesex County Bank, 26 Conn. 144, 157. But the contrary view was taken in Bank of Attica *v.* Manufacturers' & Traders' Bank, 20 N. Y. 501.

as shall be prescribed by the by-laws of the company," — has power to make a by-law, providing that no transfer of stock shall be made upon the books of the corporation until after the payment of all indebtedness to the corporation due from the person in whose name the stock stands on its books.[1]

§ **3239. Interpretation of such Regulations.** — A by-law restraining the transfer of shares while the holder is "*indebted*" to the company, embraces cases where debts have been contracted, but which are *not yet due* and payable. The word "indebted," when employed in a by-law or charter restraining a stockholder from transferring his stock while indebted to the company, is said to apply as well to debts to become due as to those which are actually due, and as well to those owing by the stockholder as *surety* or *indorser* as to those in which he is the principal debtor; since the time of negotiating a loan is the period when the directors must look out for security, and the fact that a borrower or indorser is a stockholder may induce them to be less attentive in taking security than they otherwise would be.[2] The same interpretation has been put upon a by-law of a bank which forbade the transfer of stock by any stockholder until he should have discharged "*all debts due* by him" to the association; this included *liabilities not matured* at the time of the transfer.[3] But by-laws which provide that no transfer of stock shall be allowed or valid so long as the holder is in arrears to the corporation, or in any form indebted to it, and by the terms of which, arrears to the corporation are a lien upon all stock held by any stockholder for the security of any debt owing, in any form, to the corporation

[1] Pendergast *v.* Bank of Stockton, 2 Saw. (U. S.) 108.

[2] St. Louis Perpetual Ins. Co. *v.* Goodfellow, 9 Mo. 149, 154, citing Ang. & A. Corp. 295, 445; Grant *v.* Mechanics' Bank, 15 Serg. & R. (Pa.) 240. See, also, Sewall *v.* Lancaster Bank, 17 *Id.* 285, construing a similar word in a statute.

[3] Leggett *v.* Bank of Sing Sing, 24 N. Y. 283. One becoming the owner of stock subject to this law, and having knowledge of the law, but who yet omitted to give the bank notice of his ownership, thereby enabling his vendor to have credit at the bank as a stockholder, held his stock subject to a lien for liabilities contracted to the bank by his vendor. *Ibid.*

by such stockholder, whether the same is due or not due, and whether such liability was created before or after the issue of the stock certificate,—have been held not to restrain the transfer of shares by a shareholder whose only indebtedness to the corporation was a portion of the *subscription price of his shares* which had not been called for by the directors. This conclusion is rested in part upon the propriety of construing the by-law so as to make it harmonize with the general law of the State, which restrains the transfer of shares when previous calls thereon have not been fully paid, and also upon the propriety of so construing it as to give effect to the term "in arrears,"—the court conceding that the word "indebted," standing alone, is large enough to embrace an uncalled balance due upon corporate shares.[1]

§ **3240. Not Retroactive.**— We have already seen that the by-laws of corporations are not allowed to have a retroactive operation.[2] So, where the power exists in the board of directors of a corporation to pass a prospective by-law providing that no transfer of shares shall be made by a shareholder who is indebted to the corporation, yet such a by-law cannot be made to operate so as to invalidate a transfer made *before its passage*.[3]

§ **3241. When Purchaser of Shares Chargeable with Notice of such a By-law.**— It has been reasoned that a purchaser of shares of an incorporated bank takes an *equitable assignment*, subject to the rights of the bank under its charter, of which the assignee is *bound to take notice*.[4] This is nothing more than an application of the principle that one who buys personal property, other than negotiable securities, takes no more than his vendor has to sell; but in view of the extent to which later decisions have gone in upholding the *quasi*-negoti-

[1] Kahn *v.* Bank of St. Joseph, 70 Mo. 262; distinguishing Pittsburgh &c. R. Co. *v.* Clarke, 29 Pa. St. 146, 150.

[2] *Ante*, § 1019.

[3] People *v.* Crockett, 9 Cal. 112.

[4] Farmers' Bank of Maryland *v.* Iglehart, 6 Gill (Md.), 50.

able character of corporate share certificates,[1] it may be doubted whether at the present day they would hold the same doctrine. But, however this may be, there is no difficulty in holding that a purchaser of shares who takes with *express notice* of such an incumbrance, although in the form of a by-law (assuming the same to be valid), takes subject to the rights of the corporation thereunder.[2]

§ **3242. When Tranfers Require Approval of Directors.**— The English courts have held that where the *constitution of the company* requires the approval of the board of directors in order to the validity of a transfer, a court will not deprive them of the right to act upon the matter in the first instance, nor substitute its discretion for theirs.[3] And where the deed of settlement of a banking company declared that no person should be entitled to become a transferee of shares unless he was approved of by the board of directors, it was held that the directors must not exercise the power to restrain transfers unreasonably, and that they would be controlled in this respect by a court of equity.[4]

§ **3243. Usage that Stock not Transferable where Holder Indebted to Company.**—It has been held that, in the absence of a by-law or other regulation so prescribing, a *practice* or *usage* of the corporation, to the effect that transfers of its shares cannot take place where the intending transferor is indebted to the company, is good as against a *voluntary* assignee.[5] Where the *certificate* of shares *recites* that the corporation has a lien on the shares for any indebtedness of the shareholder to it, this statement and *usage* under it have been held sufficient proof of such a regulation. And it has been held that such a usage, known to the stockholder, is a sufficient justification to the corporation for refusing to make a transfer.[6]

[1] *Ante*, § 2353.

[2] State Sav. Asso. *v.* Nixon-Jones Printing Co., 25 Mo. App. 642.

[3] Walker's case, L. R. 2 Eq. 554.

[4] Robinson *v.* Chartered Bank, L. R. 1 Eq. 32.

[5] Morgan *v.* Bank of North America, 8 Serg. & R. (Pa.) 73; *s. c.* 11 Am. Dec. 575.

[6] Vansands *v.* Middlesex County Bank, 26 Conn. 144.

But if a lien has been created in some other lawful mode, the fact that there was no usage from which such a lien on the shares in favor of the corporation could arise, is no defense to its enforcement, where it does not appear that there was any usage against it.[1]

§ 3244. **Effect of Certificate Transferable on Its Face.** — On the other hand, if a corporation issues a certificate of stock, which recites, without qualification, that the shares are *transferable*, it thereby waives any lien which it might otherwise have asserted, and estops itself from afterwards setting up any.[2] This is analogous to the rule already considered, which protects the *bona fide* holders of shares which have been issued as "paid up."[3]

§ 3245. **Power to Impose such Restraint in the Certificate.** — Without reference to the question of the power of a corporation to impose such a restraint upon alienation by a recital upon a share certificate, we have judicial authority for the proposition that where a banking corporation issues such a certificate to an original taker of its shares, reciting thereon that no transfer will be made until all indebtedness to the bank by the person in whose name the shares stand on its books shall have been paid, he *assents* to that condition, and that one who purchases from him his shares evidenced by such a certificate also *assents* to it; so that if the bank refuses a transfer because the transferor is indebted to it, the transferee cannot maintain an action against it for damages, and this although there was no *by-law* or *custom* of the bank restraining such a transfer.[4]

[1] Jennings *v.* Bank of California, 79 Cal. 323; *s. c.* 21 Pac. Rep. 852; 12 Am. St. Rep. 145.

[2] Fitzhugh *v.* Bank of Shepherdsville, 3 T. B. Mon. (Ky.) 126; *s. c.* 16 Am. Dec. 90.

[3] *Ante*, § 1680, *et seq.*

[4] Jennings *v.* Bank of California, 79 Cal. 323; *s. c.* 12 Am. St. Rep. 145; 21 Pac. Rep. 852. This decision is believed to be untenable. It goes to the length of asserting the proposition that a banking corporation can impose a restraint upon the alienation of its shares, and in effect create a mortgage of its own shares in its own favor, by a mere recital on a share certificate that it does so.

§ 3246. Statutory Lien of a Corporation upon Its Shares. It may be assumed that, in the absence of a statute, a valid by-law, or a contract, the *corporation has no lien* on the shares of a member to secure an indebtedness of the member to the corporation.[1] But it has been very common in American charters, especially in the charters of banking corporations, to provide for such a lien.[2] And such a lien may, of course, be created by a provision in the *charter*[3] of the corporation, or in a general statute governing it. Such a lien for a *general balance* is created by a charter provision that no stockholder indebted to the corporation shall be permitted to make any transfer of his stock, or receive any dividend, until such debt is paid or secured.[4] As we shall see hereafter,[5] statutes which provide that no transfer of bank stock shall be valid or effectual until it is registered in a book of the bank to be kept for that purpose, and that debts of the vendor, due to the bank, shall be first paid, are intended merely for the protection of the corporation, to give them such a lien, and enable them to know to whom dividends are due.[6] A statutory provision that no stockholder indebted to the corporation shall be allowed to make a transfer of his shares or receive a dividend until such indebtedness is discharged, extends to a *general indebtedness* (as, for instance, an indebtedness arising from discounting notes), and is not confined to an indebtedness in respect of his shares.[7] The word "indebted," in such a statute, includes the case of a note discounted at the bank, but *not* actually *due* at the time the transfer is applied for.[8] Such

[1] It has been held, apparently in deference to this theory, that a banking corporation has no lien upon its shares for debts due from the holders to the bank. Heart *v.* State Bank, 2 Dev. Eq. (N. C.) 111. *Contra*, Downer *v.* Zanesville Bank, Wright (Ohio), 477. That there is no such lien at *common law*, see *ante*, § 2317; People *v.* Crockett, 9 Cal. 112; Driscoll *v.* West Bradley &c. Co., 59 N. Y. 96.

[2] 29 Cent. L. J. 154, note.

[3] Brent *v.* Bank of Washington, 10 Pet. (U. S.) 596; German Security Bank *v.* Jefferson, 10 Bush (Ky.), 326.

[4] Kenton Ins. Co. *v.* Bowman, 84 Ky. 430; *s. c.* 1 S. W. Rep. 717.

[5] *Post*, § 3283, *et seq.*

[6] Bank of Utica *v.* Smalley, 2 Cow. (N. Y.) 770; *s. c.* 14 Am. Dec. 526.

[7] Rogers *v.* Huntingdon Bank, 12 Serg. & R. (Pa.) 77.

[8] Grant *v.* Mechanics' Bank, 15 Serg. &. R. (Pa.) 140; *s. p.* Sewall *v.* Lancaster Bank, 17 *Id.* 285.

a lien would, of course, be no lien unless it were paramount to any demand against the shares, of whatever nature or to whatever person or body politic, which may be placed upon them by the shareholder; and hence the shareholder cannot assign them, even to secure a debt due to a creditor which by statute has preference over other creditors in the distribution of assets, — *e. g.*, to the United States, — so as to give the assignee *priority* over the corporation.[1]

§ **3247. Lien Created by Articles of Incorporation.** — It is equally clear that such a lien may be created by a reservation of it in the articles of incorporation,[2] unless the governing statute expressly or impliedly prohibits the creation of such a lien, and grants a free right of alienation, as in the case of national banks, according to authoritative, but doubtful, holdings.[3]

§ **3248. Effect and Extent of such Lien.** — Such a lien has been held paramount to that acquired by the levy of an *execution* upon shares by a judgment creditor of the shareholder, although the indebtedness of the shareholder to the corporation was evidenced by notes which had been renewed and which were not due at the time of the levy.[4] Such a lien is in the nature of a right of *retainer*, and extends to all the shares of the shareholder so long as he remains indebted to the corporation, though the debt be less than the value of the shares, the corporation not being obliged to appropriate a part and transfer the rest.[5] This is not different in principle from the case where property is mortgaged to secure a debt much less than its value, in which case a judgment creditor of the mortgagor may sell the equity of redemption under his execution, and purchase it, and then redeem.[6] So the assignee of

[1] Brent *v.* Bank of Washington, 10 Pet. (U. S.) 596.

[2] Arnold *v.* Suffolk Bank, 27 Barb. (N. Y.) 424; Leggett *v.* Bank, 24 N. Y. 283.

[3] *Ante*, §§ 2319, 3236.

[4] Sewall *v.* Lancaster Bank, 17 Serg. & R. (Pa.) 285.

[5] *Ibid.*

[6] Watson *v.* Steele, 78 Ala. 361; Julian *v.* Ball, 26 Ind. 220; *s. c.* 89 Am. Dec. 460; Coombs *v.* Carr, 55 Ind.

the shares may tender to the corporation what is due, and then have an action against it for refusing to transfer.[1] But where the transferee gives the corporation *no notice* of the transfer, the lien extends to advances subsequently made by the corporation to the transferor.[2] And this is so where the *secretary* of the corporation has *actual knowledge* of the transfer, provided he acquires that knowledge in a transaction in his *private capacity*, so that he is not interested in disclosing it to the corporation.[3] Where a shareholder in an incorporated bank, which by statute had such a lien on the shares of its members, procured the bank to discount his note, and made a transfer of his shares on the last day of grace, and the transferee, on the following day, presented the assignment and demanded a transfer on the books of the bank, it was held that the bank had the right to refuse it.[4]

§ **3249. Effect of such a Lien upon Indorsers and Sureties.** Such a lien, though intended primarily for the security of the corporation, operates incidentally in favor of the *sureties* of the stockholder who is indebted to the corporation. In the case of a banking corporation which has discounted the notes of one of its shareholders, with the *indorsement* of a third person thereon, it operates in favor of the indorser, in the sense that he is entitled to be *subrogated* to the rights of the bank.[5] Hence, if the bank permits the shares to be sold, and the proceeds to be applied to discharge a debt due to the bank by the same debtor on a note of a subsequent date, the *surety* in the previous case will thereby be *discharged.*[6]

303; Wellington *v.* Gale, 13 Mass. 483; Atkyns *v.* Sawyer, 1 Pick. (Mass.) 351; *s. c.* 11 Am. Dec. 188; Raymond *v.* Holborn, 23 Wis. 57; *s. c.* 99 Am. Dec. 105; 2 Jones Mort., § 1069; note to 21 Am. St. Rep. 246.

[1] Pierson *v.* Bank of Washington, 3 Cranch C. C. (U. S.) 363. Compare Conant *v.* Reed, 1 Ohio St. 298.

[2] Jennings *v.* Bank of California, 79 Cal. 323; *s. c.* 12 Am. St. Rep. 145; 21 Pac. Rep. 852.

[3] *Post*, ch. 111. See, for a good illustration, Platt *v.* Birmingham Axle Co., 41 Conn. 255.

[4] Klopp *v.* Lebanon Bank, 46 Pa. St. 88.

[5] *Ibid.*

[6] Kuhns *v.* Westmoreland Bank, 2 Watts (Pa.), 136.

§ **3250. Waiver of this Lien by the Corporation.**—Although this lien is created by express statute, yet it may be *waived* by the corporation through its proper officers, expressly or by reasonable implication.[1] Such a waiver takes place where the corporation allows the transfer to be registered on its books; and if the shares are not fully paid up, and a call is subsequently made, the transferee cannot set up the defense to the payment of the same that the corporation had such a lien.[2] It is perhaps merely another way of stating this principle to say that, where the statute gives the corporation the *option* of prohibiting transfers of shares by shareholders indebted to it, no lien or right of retainer is created until that option is declared.[3] Evidence given by the cashier of a bank, to the effect that "if the party is in good standing, we don't question his right to a transfer," and that the stockholder was allowed a large overdraft, has been held not to show that the loan was made on the shareholder's personal credit alone, so as to waive the lien on the stock.[4]

ARTICLE III. FRAUDULENT TRANSFERS TO ESCAPE LIABILITY.

SECTION
3255. General rule: fraudulent transfers to escape liability void.
3256. The English distinction between real and sham transfers.
3257. Effect of procuring consent of the directors by fraud.
3258. Transfers after insolvency or winding-up proceedings.
3259. American doctrine: transfers to insolvent or incapable persons to escape liability, void although out-and-out.
3260. Stress laid by American judges on the question of intent.

SECTION
3261. Fraudulent intent, how proved.
3262. *Ultra vires* transfers.
3263. Transfers made with the consent of the directors but beyond their power.
3264. Reorganization for the purpose of defrauding creditors.
3265. Rule where real purchaser takes the transfer in the name of an irresponsible person to avoid liability.
3266. Transfers for the benefit of creditors of shareholders.

[1] **National Bank *v.* Watsontown Bank, 105 U. S. 217.**

[2] **Hall *v.* United States Ins. Co., 5** Gill (Md.), 484.

[3] **Perrine *v.* Fireman's Ins. Co., 22** Ala. 575.

[4] Jennings *v.* Bank of California, 79 Cal. 323; *s. c.* 12 Am. St. Rep. 145; 21 Pac. Rep. 852.

§ 3255. General Rule: Fraudulent Transfers to Escape Liability Void.—The right of a shareholder to transfer his shares is subject to this general limitation: that a *fraudulent transfer*, made with a view to avoid his liability to the company or to creditors, is void, and leaves him still liable.[1] The most usual case which can be stated in illustration of this principle is that which is presented where a shareholder in a corporation, knowing or having good reason to believe that it is about to fail, transfers his shares to an insolvent third person, intending thereby to escape his liability as a shareholder to the creditors of the corporation. Such a transfer will be held void as against the creditors of the corporation, and he will be chargeable as a shareholder in a suit in equity by a receiver of the corporation,[2] or in any other appropriate proceeding.[3]

§ 3256. The English Distinction between Real and Sham Transfers.—After much consideration of this subject, the

[1] Marcy *v.* Clark, 17 Mass. 330; McClaren *v.* Franciscus, 43 Mo. 452; Miller *v.* Great Republic Ins. Co., 50 Mo. 55; Provident Savings Institution *v.* Jackson Place Skating Rink, 52 Mo. 557; Nathan *v.* Whitlock, 9 Paige (N. Y.), 152; affirming *s. c.* 3 Edw. Ch. 215; Paine *v.* Stewart, 33 Conn. 516; Dauchy *v.* Brown, 25 Vt. 197, 210; Roman *v.* Fry, 5 J. J. Marsh. (Ky.) 634; Mandion *v.* Fireman's Ins. Co., 11 Rob. (La.) 177; Wehrman *v.* Reakirt, 1 Cin. Sup. (O.) 230; Veiller *v.* Brown, 18 Hun (N. Y.), 571; Central Ag. &c. Asso. *v.* Alabama &c. Co., 70 Ala. 120, 135; *s. c.* 9 Am. Corp. Cas. 8, 15; Bowden *v.* Santos, 1 Hughes (U. S.), 158; Re Bachman, 12 Nat. Bank. Reg. 223; Re Reciprocity Bank, 22 N. Y. 9; Aultman's Appeal, 98 Pa. St. 505; Chinnock's case, Johns. (Eng. Ch.) 714; Costello's case, 2 De Gex, F. & J. 302; Budd's case, 3 De Gex, F. & J. 297; Ex parte Bennett, 18 Beav. 339; Lund's case, 28 Beav. 465; Eyre's case, 31 Beav. 177; Daniell's case, 22 Beav. 43; Munts's case, 22 Beav. 55; Cox's case, 33 L. J. (Ch.) 145; Payne's case L. R. 9 Eq. 223; Williams's case, L. R. 9 Eq. 225, note; Capper's case, L. R. 3 Ch. 458; Mann's case, L. R. 3 Ch. 459, note; Castellan *v.* Hobson, L. R. 10 Eq. 47. Compare Jessopp's case, 2 De Gex & J. 638; Slater's case, 35 Beav. 391; King's case, L. R. 6 Ch. 196; Harrison's case, L. R. 6 Ch. 286; Master's case, L. R. 7 Ch. 292; Hakim's case, L. R. 7 Ch. 296, note; Bishop's case, L. R. 7 Ch. 296, note; Mitchell's case, L. R. 9 Eq. 363; Maynard *v.* Eaton, L. R. 9 Ch. 414; Christensen *v.* Quintard, 8 N. Y. Supp. 400.

[2] Bowden *v.* Johnson, 107 U. S. 251; Davis *v.* Stevens, 17 Blatchf. (U. S.) 259; Lesassier *v.* Kennedy, 36 La. Ann. 539.

[3] Rider *v.* Fritchey, 49 Ohio St. 285; *s. c.* 15 L. R. A. 513; 30 N. E. Rep. 692.

English courts have settled upon the rule that a man may transfer his shares to *a man of straw*, at a time when the company is in a failing condition, for the sole purpose of escaping liability, and for a nominal consideration merely, or as a mere gift; and that if the transfer is out-and-out, — is not merely colorable — a sham — the transferee remaining a trustee for the transferor, — the device will be successful; the transferor will escape liability as a contributory, and honest shareholders and creditors will suffer accordingly.[1] But if the transaction is merely *colorable*, — if, in fact, the transferee is a mere nominee of the transferor, so that, as between themselves, there has been no real transfer, but in the event of the company becoming prosperous the transferor would participate in the profits, the transfer will be held for naught, and the transferor will be put upon the list of contributories.[2] The rule that one who has transferred his shares colorably to an irresponsible person, to escape liability, remains a contributory, is not displaced by the fact that the constitution of the company declares that trusts shall not be recognized, and that the person on the register shall be deemed the beneficial owner of the shares.[3] The rule is thus expressed by Sir Nathaniel Lindley: "Notwithstanding there is a complete transfer, the transferor will be held a contributory if the evidence shows, not only that the transfer was made to get rid of a liability, but that the transfer was not a real transaction, and was not intended to divest the interest of the transferor, and to

[1] Re Taurine Co., 25 Ch. Div. 118; Jessopp's case, 2 De Gex & J. 638; Bishop's case, L. R. 7 Ch. 296, note; Master's case, L. R. 7 Ch. 292; Hakim's case, L. R. 7 Ch. 296, note; Harrison's case, L. R. 6 Ch. 286; Williams's case, 1 Ch. Div. 576; King's case, L. R. 6 Ch. 196; Weston's case, L. R. 4 Ch. 20; De Pass's case, 4 De Gex & J. 544; Slater's case, 35 Beav. 391; Garstin's case, 10 Week. Rep. 457; Hatton's case, 8 Jur. (N. S.) 380. English cases, where the transfer was held good because *out-and-out*, are referred to in detail in Thomp. Stockh., § 213. English cases, where the transfer was held void because a *sham*, are set out in detail, *Id.*, § 214.

[2] Budd's case, 3 De Gex, F. & J. 297; Chinnock's case, Johns. (Eng. Ch.) 714; Costello's case, 2 De Gex, F. & J. 302; Hyam's case, 1 De Gex, F. & J. 75; Payne's case, L. R. 9 Eq. 223; Ex parte Kintrea, L. R. 5 Ch. 95; Gilbert's case, L. R. 5 Ch. 559.

[3] Chinnock's case, Johns. (Eng. Ch.) 714.

render the transferee the *bona fide* owner of the shares, but that the transferee held them subject to the orders of the transferor; and although it cannot, perhaps, be denied that in the cases in question the relation of trustee and *cestui que trust* was created, it is obvious that the sole object of the trust was to screen the transferor from liability. The cases show that such devices will not have the effect desired by those who practice them."[1] This language was quoted in an important case by the Lord Justice James, to whom it appeared to express the result of the cases correctly.[2]

§ 3257. Effect of Procuring Consent of the Directors by Fraud. — If, in addition to this, the constitution of the company gives the directors the right to veto a transfer, and they are induced to consent to it by misrepresentations of the transferor, the case becomes still clearer.[3] In such a case, it is assumed that if the truth had been told to the directors they would have disallowed the transfer, and a court of equity will not allow falsehood thus to become successful.[4] On the other hand, where the board of directors possess this power, it is their duty to inquire into the responsibility of the transferee, and if his name and address are correctly given, and they make no such inquiry, the English courts find in this circumstance an additional reason for treating the transfer as valid.[5] The mere fact that the directors were not in the habit of inquiring about transferees has been regarded as immaterial; since it was their duty to inquire, and the tendency of misrepresentations would be to allay suspicion.[6] If the directors accept an insolvent transferee with full knowledge, that ends the liability of the transferor.[7] Americans may smile at the statement that the mere fact that the transferee is described to the directors as a "gentleman,"

[1] Lindley on Part., 2d ed., 1352.

[2] King's case, L. R. 6 Ch. 199.

[3] Ex parte Kintrea, L. R. 5 Ch. 95.

[4] Payne's case, L. R. 9 Eq. 223; Williams's case, L. R. 9 Eq. 225, note.

[5] Williams's case, 1 Ch. Div. 576; Weston's case, L. R. 4 Ch. 20.

[6] Williams's case, L. R. 9 Eq. 225, note.

[7] Chynoweth's case, 15 Ch. Div. 13.

when he is not entitled to be so called, — is not even a briefless barrister, — will not invalidate the transfer.[1]

§ 3258. **Transfers after Insolvency or Winding-up Proceedings.** — It was held by Lord Romilly, M. R., under the Winding-up Act, 1848, that where shares in a company are transferred in the interval between the presentation of a petition for winding up and the date of the winding-up order, the transferor, and not the transferee, is the proper person to be settled upon the list of contributories. Although this decision professedly follows the language of a statute,[2] the reasoning is so broad that I think it may be appealed to in support of the general doctrine that after the commencement against a company of proceedings in bankruptcy, or in liquidation, the power of members to escape liability by transferring their shares is at an end.[3] The company then, in the language of other cases, ceases to be "a going concern"; and when this has taken place, when the company has "stopped,"— as, by transferring all its assets and business to another company, so that it is virtually dissolved, — then the courts of equity of that country deny to its shareholders the privilege of cheating its creditors and their co-shareholders, by transferring their shares to a man of straw; but they put it on the ground, not of *fraud*, but that there are no shares to transfer, and that the provisions of the deed of settlement relating to the trans-

[1] Master's case, L. R. 7 Ch. 292; Bishop's case, *Id.* 296.

[2] By section 3 of this statute (11 & 12 Vict., ch. 45), it is enacted, among other things, as follows: "The word 'company' shall mean any partnership, association, or company, corporate or incorporate, to which this act applies. The word 'member' shall mean any person entitled to a share of the assets or accruing profits of any such company at the time of presenting the petition for dissolving the same, or winding up the affairs thereof, under this act. The word 'contributory' shall include every member of a company, and also every other person liable to contribute to the payment of any of the debts, liabilities, or losses thereof, whether as heir, devisee, executor, or administrator of a deceased member, or as a former member of the same, or as heir, devisee, executor, or administrator of a former member of the same, deceased, or otherwise howsoever."

[3] Glanville's case, L. R. 10 Eq. 479.

fer of shares have become exhausted.[1] But it is not to be inferred from anything that has been said here, or elsewhere in this work, that the *mere happening of the insolvency* of *an American corporation*, however publicly known, puts an end to the power of its shareholders to transfer their holdings, though they may not thereby escape liability in all cases by so doing. The *general rule* is that a transfer by a stockholder is as good after the insolvency of the corporation as before, and that it imposes on the transferee the liability of a stockholder, in like manner as though made before.[2] But it remains that the insolvency of the corporation is an exceedingly important *evidentiary fact* in determining whether or not a transfer of shares is void as against the creditors of the corporation.[3] In one case it has been held in round terms that, after a national bank has become insolvent and closed its doors for business, the liability of its stockholders to its creditors becomes so fixed that any transfer of shares thereafter made must be held inoperative and void as against its creditors.[4]

§ 3259. American Doctrine: Transfers to Insolvent or Incapable Persons to Escape Liability Void, although Out-and-out. — It is thought that the American doctrine on this subject may fairly be summed up as follows: A transfer of shares in a failing corporation, made by the transferor with the purpose of escaping his liability as a shareholder to a person who, from any cause,[5] is incapable of responding in respect of such liability, is void as to creditors of the company and as to other shareholders, although, as between the transferor and the transferee, the transfer may have been out-and-out.[6] This conclusion necessarily results from the Ameri-

[1] Lankester's case, L. R. 6 Ch. 905, note; Chappell's case, L. R. 6 Ch. 902, Sir G. Mellish, L. J., dissenting; Allin's case, L. R. 16 Eq. 449, before Lord Selborne, L. C.

[2] Robinson *v.* Beall, 26 Ga. 17. Compare Morgan *v.* Brower, 77 Ga. 627; Lesassier *v.* Kennedy, 36 La. Ann. 539.

[3] *Ante*, § 3241.

[4] Irons *v.* Manufacturers' Nat. Bank, 17 Fed. Rep. 308.

[5] Transfers to persons who are *non sui juris* are separately considered in the next article. *Post*, § 3270, *et seq.*

[6] Nathan *v.* Whitlock, 3 Edw. Ch. (N. Y.) 215; *s. c.* affirmed on appeal, 9 Paige (N. Y.), 152; Provident Sav.

can doctrine that the capital stock of a corporation is a trust fund for the security and benefit of creditors.[1] This fund consisting not only of money which has been paid in on account of stock subscriptions, but also of money which subscribers have agreed to pay in,[2] it is obvious that a court of equity will not allow that portion of it which consists of unpaid subscriptions to be frittered away by the transfer of shares from solvent to insolvent persons, with the mere purpose of escaping the obligations arising out of the contract of subscription and accruing to creditors. Such an arrangement cannot stand, even if done with the consent of the board of directors, because the giving of such consent would involve a breach of trust on their part.[3]

§ 3260. Stress Laid by American Judges on the Question of Intent. — It will be observed, upon a reading of the American cases, that they lay the principal stress on the question of an *intent* on the part of the transferor to escape liability.[4]

§ 3261. Fraudulent Intent, how Proved. — This intent is generally incapable of direct proof, for the reason that a per-

Inst. *v.* Jackson Place Skating Rink, 52 Mo. 557; McClaren *v.* Franciscus, 43 Mo. 452; Miller *v.* Great Republic Ins. Co., 50 Mo. 55; Marcy *v.* Clark, 17 Mass. 330.

[1] *Ante*, § 2951.

[2] *Ante*, § 2952.

[3] Nathan *v.* Whitlock, 3 Edw. Ch. (N. Y.) 215; *s. c.* affirmed on appeal, 9 Paige (N. Y.), 152.

[4] Read, for example, the opinions in Marcy *v.* Clark, 17 Mass. 330, 334, Parker, C. J.; Johnson *v.* Laflin, 5 Dill. (U. S.) 65, Dillon, J.; McClaren *v.* Franciscus, 43 Mo. 452, 467, Wagner, J.; quoted with approval in Provident Sav. Inst. *v.* Jackson Place Skating Rink, 52 Mo. 557. It is said in the official syllabus of a case where the transferor of certain shares sought to establish his ownership as against his transferee, that "a regular transfer of shares of corporate stock will not be disturbed unless it is satisfactorily shown that it was conditional, *designed* to serve as collateral or pledge to secure a payment, or was *simulated* and not *intended* to transfer the ownership." Small *v.* Saloy, 42 La. Ann. 183; *s. c.* 7 South. Rep. 450. This is the rule in regard to out-and-out conveyances of land: the deed may be shown to have been intended as a mortgage, but the proof must be clear. So, it has been reasoned that the rule as to a transfer of corporate stock to escape liability, if applicable at all *in California*, does not apply unless the transfer was for the purpose of escaping liability, and to a person whom the stockholder *knows* to be irresponsible. Moore *v.* Boyd, 74 Cal. 167; *s. c.* 15 Pac. Rep. 670, opinion by Hayne, C.

son who will make a fraudulent conveyance to escape liability to creditors will seldom hesitate to commit the necessary perjury to sustain it. It must therefore be *inferred from circumstances.* The circumstance that the corporation or the transferee, or both, were at the time notoriously insolvent would, it should seem, be sufficient to warrant the inference of such an intent;[1] and such a circumstance would overbear the testimony of a single witness.[2] On the other hand, it is obvious that the circumstance that the corporation was "a going concern," its solvency unsuspected by the public, would tend to overcome the presumption of fraudulent intent; since in such cases there is, *prima facie*, an unrestricted right to transfer to persons capable of taking.[3] Nor is the transferor bound at his peril to know that the transferee is solvent. Such a requirement would put upon the transfer of corporate shares a different rule from that which obtains with reference to the transferability of other property.[4] Where, on the other hand, the corporation was insolvent, and while an action was pending against it by a creditor, upon a demand in respect of which a stockholder would become individually liable, a transfer by him of his shares to an insolvent was of no avail in discharging his personal liability.[5]

§ **3262. Ultra Vires Transfers.** — Where, by the law of the corporation,[6] whether founded in an express statute, or in a

[1] Bowden *v.* Johnson, 107 U. S. 251, 262. "If the stockholder knew of the insolvency at the time of the transfer, it would be very strong evidence of fraud, and it would be hard to resist the conclusion that such transfer was made in bad faith." Adams, J., in Miller *v.* Great Republic Ins. Co., 50 Mo. 55, 57.

[2] Bowden *v.* Johnson, *supra;* citing Clark *v.* Van Riemsdyk, 9 Cranch (U. S.), 153.

[3] Johnson *v.* Laflin, 5 Dill. (U. S.) 65; *s. c.* 6 Cent. L. J. 131; *s. c.* affirmed, 103 U. S. 800. The author does not believe that this case was rightly decided on its merits. It was a case where certain rascals, in charge of a tottering national bank, used its funds, through a broker, in buying in its own shares; and the author does not believe that the sellers ought, under the circumstances, to have been regarded as innocent.

[4] Miller *v.* Great Republic Ins. Co., 50 Mo. 55, 57.

[5] Rider *v.* Fritchey, 49 Ohio St. 285; *s. c.* 15 L. R. A. 513; 30 N. E. Rep. 692.

[6] Borland *v.* Haven, 37 Fed. Rep. 394.

valid by-law, or, as in Pennsylvania, in judicial construction,[1] the original subscriber remains liable, notwithstanding he may have transferred his shares to another, and the transferee assumes no liability to the company for subsequent calls,[2] the question of the *motive* of the transferor, of course, becomes immaterial; and the rule would necessarily be the same in Ohio[3] and in Virginia,[4] where the transferor remains liable, and the transferee also becomes so.[5] And we have already seen that the English doctrine is to the effect that where the *directors* have, by the law of the company, *a negative* on the transfer, their consent to it, procured by *fraud*, is void.[6]

§ **3263. Transfers Made with Consent of the Directors, but Beyond Their Power.** — We have already seen that the directors of a corporation have no power, either as against creditors or as against stockholders, to give away the trust fund of which the capital consists.[7] Decisions in England, which, however, do not formulate the doctrine in this way, are in accord with it. Transfers made *to a nominee of the directors*, in pursuance of arrangements between discontented members and the directors, whereby the former are permitted to retire from the company, have been treated as involving acts inconsistent with the duty of the directors, and beyond their power, and such transferors have been held liable as contributories.[8] Such transfers are *ultra vires* on another

[1] The rule in Pennsylvania is that a subscription to the stock of a railroad company creates a debt against the subscriber, from which he cannot relieve himself by an assignment or transfer made without the sanction of the directors. Graff *v.* Pittsburgh &c. R. Co., 31 Pa. St. 489; Pittsburgh &c. R. Co. *v.* Clarke, 29 Pa. St. 146.

[2] Messersmith *v.* Sharon Sav. Bank, 96 Pa. St. 440; Franks Oil Co. *v.* McCleary, 63 Pa. St. 317; Palmer *v.* Ridge Mining Co., 34 Pa. St. 288; Delaware &c. Canal Co. *v.* Sansom, 1 Binn. (Pa.) 70. Compare the following case arising under a Michigan statute: Merrimac &c. Mining Co. *v.* Levy, 54 Pa. St. 227; *s. c.* 93 Am. Dec. 697.

[3] *Ante*, §§ 3177, 3226.

[4] *Ante*, § 3227.

[5] Borland *v.* Haven, 37 Fed. Rep. 394.

[6] *Ante*, § 3257.

[7] *Ante*, § 1512.

[8] Morgan's case, 1 De Gex & S. 750; Bennett's case, 5 De Gex, M. & G. 284; *s. c.* 18 Beav. 339; Nathan *v.* Whitlock, 3 Edw. Ch. 215; affirmed on appeal, 9 Paige, 152.

ground, hereafter stated:[1] they are tantamount to a transfer to *the company* itself; and, as a general rule, a corporation has no power to receive back its shares from its members.[2]

§ 3264. Reorganization for the Purpose of Defrauding Creditors.—If the formation of a new company is forwarded by persons interested in an old one, which is insolvent, for the purpose of relieving those interested in the old company and fastening its liabilities upon the members of the new, and the new company, after its formation, buys the property of the old, and becomes liable to the creditors of the latter for the amount due them, such creditors are not affected by the fraud, and can compel the stockholders of the old company to pay their subscriptions.[3] On the other hand, where one owned all the shares of stock in a bank which owed no debts, and he was proceeding to wind up its business when certain others solicited a transfer of the charter to them, in order that they might do a banking business, and, under advice of counsel as to how it could be done without liability on his part, he transferred all the stock to such other persons without any consideration therefor, and the bank transferred to him all of the assets and property belonging to it, he giving notice of the transfer of the stock under section 1496 of the Georgia Code, and thereupon the new owners of the stock paid in more than the amount of the property before the transfer, and proceeded to do a banking business, subsequent creditors of the bank, who became such after the notice of the transfer of the stock was published, and who did not know of or rely on the conduct of the original stockholder, had no right of action against him, he having acted in good faith throughout the transaction.[4]

§ 3265. Rule where Real Purchaser Takes the Transfer in the Name of an Irresponsible Person to Avoid Liability.—The rule is the same where the real purchaser of corporate

[1] *Post*, § 3277.

[2] *Ante*, § 2054.

[3] Jewell *v.* Rock River Paper Co., 101 Ill. 57. See *ante*, § 271.

[4] Morgan *v.* Brower, 77 Ga. 627.

shares, instead of perfecting the transfer in his own name, — or, being a corporation, in its own name, — causes the transfer to be registered in the name of an irresponsible third person, for the purposes of escaping the personal liability of a shareholder. In such a case the real, and not the colorable, transferee will be charged with the liability of a stockholder, and this notwithstanding what appears on the face of the books. It was so held where one national bank, acquiring some of the shares of another national bank by the foreclosure of a pledge, caused them to be transferred from the pledgor to one of its own clerks.[1] But this principle has been denied by the same court where the pledgee had the shares transferred in the first instance to an irresponsible trustee to avoid personal liability in respect of them;[2] and the two decisions cannot be reconciled, and the latter is unsound.[3]

§ 3266. Transfers for the Benefit of Creditors of Shareholders. — The individual liability of a shareholder in a national bank[4] does not prevent the shareholder, even when he is a director in the bank, from making *a general assignment of his property*, including his shares, for the payment of his debts; but if such a general assignment of his property will stand against the attacks of any particular creditor, it will stand against the attack of the receiver or other representative of the creditors of the corporation in which he was a shareholder. At the same time it was conceded, speaking for the court, by Mr. Chief Justice Fuller, that "the shareholder cannot transfer his shares when the corporation is failing, or manipulate a release therefrom, for the purpose of escaping his liability. And the principle is the same where the shares are paid up, but the shareholder is responsible in respect thereof to an equal additional amount."[5]

[1] National Bank *v.* Case, 99 U. S. 628.

[2] Anderson *v.* Philadelphia Warehouse Co., 111 U. S. 479.

[3] Opposed to the latter decision, and following the former, is Case *v.* Small, 4 Woods (U. S.), 78; *s. c.* 10 Fed. Rep. 722. Upon the question whether the original vendor in such a case is entitled to *contribution from a fraudulent sub-vendee*, see the misdecided case of Lesassier *v.* Kennedy, 36 La. Ann. 539.

[4] Rev. Stats. U.S., §§ 5151, 5234.

[5] Peters *v.* Bain, 133 U. S. 670, 692; *s. c.* 33 L. ed. 696; 10 Sup. Ct. Rep. 354.

Article IV. Transfers to Persons Incapable of Contracting.

Section
3270. Divisions of the subject.
3271. Transfers to infants.
3272. Effect of transfer through an infant to an adult.
3273. What if company wound up during minority.
3274. Ratification after majority.
3275. Married women.

Section
3276. Transfers of shares to the company itself void.
3277. Exceptions to this rule.
3278. Want of knowledge on part of transferor.
3279. Transfer to a non-existent or fictitious person.

§ **3270. Divisions of the Subject.** — Closely allied to the subject of transfers to men of straw [1] comes a numerous class of cases where shares of stock have been transferred to, or otherwise placed in, the names of persons incapable in law of taking them. What is said in considering these cases must be read in connection with a former chapter where we had occasion to consider the question who may become shareholders in corporations.[2] Transfers of this kind have been frequently made by the transferor for the purpose of escaping liability as a contributory; but sometimes they have been in the nature of *bona fide* advancements to children, investments for infants and married women, or assignments to nominees of the directors, in pursuance of power conferred in the constitution of the company to become the beneficial owner of its own stock. The general rule is that transfers to a transferee incapable of taking are void as to creditors and non-assenting shareholders, and that the transferor remains a contributory, as though no transfer had been made.[3] I shall examine transfers and allotments of this kind under three heads: 1. Transfers to infants. 2. Transfers to married women. 3. Transfers to the company itself, or to its nominees in trust for it.

§ **3271. Transfers to Infants.** — 1. It is not intended here to consider transfers to infants which are merely colorable, contrived by the transferor to escape liability as a contribu-

[1] *Ante*, § 3265.

[2] *Ante*, § 1090, *et seq.*

[3] Marcy *v.* Clark, 17 Mass. 330; United Society *v.* Eaglebank, 7 Conn. 456; Veiller *v.* Brown, 18 Hun (N. Y.), 571; *ante*, § 3265.

tory. Such transfers refer themselves to another division of this subject, and, as there seen, are inoperative and void.[1] But, upon familiar grounds, *bona fide* transfers of shares to an infant are not void, but voidable, at his election, after he attains his majority. In the absence of special provisions in the governing statute, there is nothing to distinguish a contract to take shares from any other contract made by or for an infant.[2] The rule, as already seen, in the case of an original subscription, is that if one subscribes for stock, in the name of minors, for the purpose of avoiding personal responsibility if the corporation should become insolvent, and receives the benefit of the stock, he will be liable for the corporate debts.[3]

§ 3272. Effect of Transfer Through an Infant to an Adult. The settled rule, then, seems to be that a transfer to an infant is voidable, but not void:[4] voidable at the election of the infant or of the company, or, in case of the winding-up of the company, at the election of the liquidator or receiver, who represents all parties in interest except the infant. It follows, then, that the mere fact that a transfer of shares has been made *through* several infants to an adult, the conveyances having been attended with due formality, will not entitle the liquidator to put the name of the original

[1] *Ante*, § 3265, *et seq.;* Capper's case, L. R. 3 Ch. 458; Mann's case, L. R. 3 Ch. 459, note; Weston's case, L. R. 5 Ch. 614; Richardson's case, L. R. 19 Eq. 588.

[2] Lumsden's case, L. R. 4 Ch. 31; Ebbett's case, L. R. 5 Ch. 302; Baker's case, L. R. 7 Ch. 115; Maguire's case, 3 De Gex. & S. 31; Mitchell's case, L. R. 9 Eq. 363; Wilson's case, L. R. 8 Eq. 240; Hart's case, L. R. 6 Eq. 512. In a suit in equity by a banking corporation to subject to the payment of a debt certain of its shares alleged to have been held by A.'s children and others for his use, it appeared that the stock had stood for several years in the names of such persons, and that they had voted upon it without objection by the corporation; and it was hence held that the corporation was estopped from treating the subscription as a fraudulent use, by the original subscriber, of mere names to secure a greater number of votes than he would otherwise have been entitled to if the stock had stood in his own name. Creed *v.* Lancaster Bank, 1 Ohio St. 1.

[3] Castleman *v.* Holmes, 4 J. J. Marsh. (Ky.) 1; Roman *v.* Fry, 5 J. J. Marsh. (Ky.) 634.

[4] Lumsden's case, L. R. 4 Ch. 31.

transferor on the list in place of the last transferee, although the company did not know that the intermediate conveyees were infants. The last shareholder being in all respects competent, the company was estopped from disputing his title to those shares. From the time they had a good shareholder on their register, in respect to whom they were bound, and who was bound in respect to them, they ceased to have any interest in the voidable character of the intermediate transfers.[1]

§ 3273. What if Company Wound up During Minority. — Such a contract, however, is voidable by the company or its representative until ratified by the infant, after attaining his majority. Hence, if the company is wound up before that time, the person who has purchased the shares for the infant, executed the necessary conveyance, and entered into the necessary covenants for him, may be held as a contributory;[2] for it cannot be assumed in such a case that the infant, after attaining his majority, would ratify the transaction; and this was done even where the infant, having attained his majority after the winding up, expressed by affidavit a desire to retain the shares, although he could not, at that time, pay the amount due on them.[3] Upon like grounds, where a father transfers his shares to an infant, and the company is wound up before the latter attains his majority, the transfer will be treated as void, and the transferor held as a contributory.[4] But where a father applied for shares in the name of his infant son, and paid the deposit thereon, and the company refused to allow him to execute the deed on behalf of his son, and he did no further act, he was not a contributory.[5] In an early case in Kentucky, a corporator endeavored to escape liability to creditors by taking shares in the names of infants. This was treated as "a fraud on the community."[6] Where,

[1] Gooch's case, L. R. 8 Ch. 266; reversing *s. c.* L. R. 14 Eq. 454.

[2] Reaveley's case, 1 De Gex. &. S. 550; Richardson's case, L. R. 19 Eq. 588; Ex parte Reavely, 1 Hall & T. 118; Castello's case, L. R. 8 Eq. 504; Symon's case, L. R. 5 Ch. 298.

[3] Castello's case, L. R. 8 Eq. 504.

[4] Weston's case, L. R. 5 Ch. 614, Reid's case, 24 Beav. 318.

[5] Maxwell's case, 24 Beav. 321.

[6] Roman *v.* Fry, 5 J. J. Marsh. (Ky.) 634.

however, the shares were sold in open market, and purchased by an infant, of which fact the transferor had no knowledge, and the company, after discovering this fact, failed for more than two years — at the expiration of which time the company was wound up — to notify the transferor of such fact, and that they had repudiated the transfer on account of it, the laches of the company precluded the right to put the name of the transferor again on the register.[1] Where a father purchased shares, and had them registered in the name of his infant son, whom he personated, upon winding up the son's name was removed from the register, and the father made a contributory in his stead.[2]

§ **3274. Ratification After Majority.** — What circumstances will amount to a *ratification* of a contract for the purchase is a question to be determined largely upon the facts of each case. The English courts have, in several cases, acted upon the principle that the fact that a person allows his name to remain for a length of time on the list of contributories of a company, without making any objection, does not raise an equity against his applying to have it removed, where no loss is sustained by the estate which would have been avoided if the application had been made earlier.[3] Some *distinct act,* they have held, must be shown, to make him liable; and such an act was not discovered in the fact that his solicitor had attended, for himself and others, at a judge's chambers, to make opposition to a judicial order for a call.[4] Other of those courts have discovered an intention to ratify in failing to repudiate, for *two years* after majority, the company being a going concern.[5] And where the infant acquiesced for five months after majority, and transferred some of his shares, and did not object till four months after winding up, it was held that there was a ratification.[6] In another case, acqui-

[1] Parson's case, L. R. 8 Eq. 656.

[2] Richardson's case, L. R. 19 Eq. 588.

[3] Shewell's case, L. R. 2 Ch. 387; Hart's case, L. R. 6 Eq. 512.

[4] Wilson's case, L. R. 8 Eq. 240.

[5] Mitchell's case, L. R. 9 Eq. 363.

[6] Lumsden's case, L. R. 4 Ch. 31.

escence for more than *a year* was deemed sufficient, where the late infant had executed a transfer of his shares;[1] but the contrary was held of an acquiescence of three years *without knowledge* that his name was on the list.[2] And it seems that the infant will be held in any case, on the ground of *fraud*, where he procures the shares with the intention of keeping them if the company succeeds, and repudiating them if it fails.[3]

§ **3275. Married Woman.** — 2. No general rule can be suggested, applicable to the different States of the Union, as to the effect of a contract of a married woman to take shares in a corporation, and her liability in respect of such an engagement, it being a question which refers itself, in each State, to the local law.[4] To this statement an exception must be made in the case of corporations created by or under statutes of the *United States*. Thus, as elsewhere seen, a married woman has the legal capacity to receive a transfer of stock in a *national banking* corporation, though the consideration may have proceeded wholly from the husband.[5] We have seen[6] that, by the principles of the common law, the *husband* is *liable for calls* in respect of shares held by his wife before marriage; and that if a husband subscribes for shares in the name of his wife, in a corporation created under the laws of a State where married women are under the common-law disability, he makes himself answerable to creditors in respect of them.[7] In England, even prior to the late Married Woman's Property Act, — and this is no doubt the rule in *equity* in many of the United States, — if a married woman, having separate property, enters into a pecuniary engagement, whether by ordering goods or otherwise, which, if she were a *feme sole*, would constitute her a debtor, and, in entering into such an engagement, she purports to contract, not for her husband, but for herself, and on the credit of her sep-

[1] Ebbett's case, L. R. 5 Ch. 302.

[2] Baker's case, L. R. 7 Ch. 115.

[3] The Master of the Rolls in Ebbett's case, L. R. 5 Ch. 302.

[4] *Ante*, §§ 1091, 1096.

[5] Keyser *v.* Hitz, 133 U. S. 138.

[6] *Ante*, § 1098.

[7] National Commercial Bank *v.* McDonnell, 92 Ala. 387; *s. c.* 9 South. Rep. 149. Compare *ante*, § 3211.

arate estate, and it is so intended by her and so understood by the person with whom she is contracting, an obligation is thereby created for which the person with whom she contracts has a right to make her separate estate liable; and the question whether the obligation was contracted in this manner must depend upon the facts and circumstances of each particular case.[1] These rules have been held applicable to a married woman holding shares in a joint-stock company. There is held to be nothing in the nature of such a company, in the absence of any special provision of its constitution,[2] to prevent a married woman from being a shareholder in her own right, so as to bind her separate estate. Therefore, where a married woman, having a separate estate, contracted to take shares in her own name in a joint-stock company, which was afterwards wound up, Vice-Chancellor Kindersley, being of opinion that the contract was entered into on the credit of her separate estate, and that the deed of settlement did not exclude married women from being shareholders, so as to bind their separate estate, placed the married woman on the list of contributories in her own right, so as to bind her separate estate.[3] Where the *status* of a married woman remains as at common law, if she owned the stock before her coverture, after which time her husband reduced it into his possession, in the event of the insolvency of the corporation, he, of course, will be liable to creditors; but where he did not thus reduce the shares into his possession, but allowed the wife to receive the dividends, she was held responsible to the creditors of the corporation under a general statute making shareholders individually liable.[4] This ruling, however, seems contrary to the general tenor of the English cases, which hold

[1] Johnson *v.* Gallagher, 3 De Gex, F. & J. 494; Mrs. Matthewman's case, L. R. 3 Eq. 781, 787.

[2] Such as appears to have controlled in Angas's case, 1 De Gex & S. 560.

[3] Mrs. Matthewman's case, L. R. 3 Eq. 731; and so in Luard's case, 1 De Gex, F. & J. 533. Power of married woman to transfer stock without consent of her husband: Howard *v.* Bank of England, L. R. 19 Eq. 295. *Mandamus* awarded to compel registry of shares in the name of a married woman: Reg. *v.* Carnatic R. Co., L. R. 8 Q. B. 299.

[4] Matter of Reciprocity Bank, 22 N. Y. 9.

that where a man marries a shareholder, and allows the shares to remain in her name, he will be a contributory in respect of them;[1] but both husband and wife should be put on the list, since, if she survives, her liability will survive also.[2] But one who marries a female shareholder, without reducing her shares into his possession, is liable as a contributory only in respect of the liabilities of the company accruing or incurred during the coverture.[3] Upon grounds fully stated elsewhere,[4] if a married woman's shares are held by *trustees* for her, in the absence of statutes providing otherwise, they must respond as shareholders, and look to her for indemnity.[5]

§ 3276. Transfers of Shares to the Company Itself Void. — 3. The general rule is, that unless the governing statute or constitution of a company authorizes it in express terms to purchase its own shares, such a purchase is *ultra vires*.[6] Where this rule prevails, the selling shareholder will remain liable to creditors, unless he sells his shares innocently to one capable in law of purchasing and holding them, not knowing that such purchaser is using the funds of the corporation;[7] and not even in that case, according to the best theory.[8] The reason is, that he gets—without rendering a lawful consideration—a part of those assets which are a trust fund for the creditors; and the fact that he gets them *innocently* furnishes no reason whatever why he should not restore them.[9]

§ 3277. Exceptions to This Rule. — Authority for stating some exceptions to this rule will be found in the American

[1] Burlinson's case, 3 De Gex & S. 18; Sadler's case, 3 De Gex & S. 36; White's case, 3 De Gex & S. 157.

[2] Sadler's case, 3 De Gex & S. 36.

[3] Kluht's case, 3 De Gex & S. 210.

[4] *Ante*, § 3194.

[5] Butler *v.* Cumpston, L. R. 7 Eq. 16.

[6] *Ante*, § 2054.

[7] Johnston *v.* Laflin, 103 U. S. 800; affirming *s. c.* 5 Dill. (U. S.) 65.

[8] Crandall *v.* Lincoln, 52 Conn. 73, 107; *s. c.* 52 Am. Rep. 560.

[9] But it has been held that a stockholder who sells his stock *to a director* of the corporation and receives therefor the notes which he has given to the corporation for the same, is not, by reason of entries on the books of the corporation, which do not themselves evidence fraud, affected with notice of a fraudulent conspiracy between the directors and the purchaser to wreck the corporation. Alexander *v.* Rollins, 14 Mo. App. 109; *s. c.* 84 Mo. 657. See, also, Bent *v.* Hart, 10 Mo. App. 143, 146.

cases, and in others the rule is denied entirely.[1] Thus, it has been held that a corporation may take its own stock *in payment of debts* owing to it, and may hold and sell stock thus acquired.[2] The directors have power to sell such stock and take notes for the price, under the general power which they possess of managing the corporate business.[3] So, a *bequest* to a corporation of its own shares has been held valid.[4] But, whilst stock thus taken by the corporation *in payment* or *pledge* does not *merge* so that it may not be reissued,[5] it cannot be voted at corporate elections; for it is not to be tolerated that the power should thus be put into the hands of the officers of corporations of securing themselves against the possibility of removal.[6] An insurance company, doing business under the laws of Ohio, being in full operation, with a capital of $300,000, the amount authorized by its charter, resolved, through its board of directors, that any stockholder indebted to the company on stock notes might have the privilege of paying any part or all of such indebtedness in the capital stock of the company, at a rate specified in the resolution. The Court of Appeals of New York held that this transaction was valid. The court was not aware of any common-law principle which forbade it; nor was it shown to be in contravention of any provision of the charter of the company, or of any other statute of Ohio.[7] This decision is not only against the weight of authority, but it is incapable of vindication upon sound principles. We have already seen [8] that the debts due a corporation by its stockholders on their stock subscrip-

[1] *Ante*, § 2062.

[2] Barton *v.* Port Jackson &c. Plank-road Co., 17 Barb. (N. Y.) 397; Cooper *v.* Frederick, 9 Ala. 738; Taylor *v.* Miami Exporting Co., 5 Ohio, 162; *s. c.* 22 Am. Dec. 785; Bank of Columbus *v.* Bruce, 17 N. Y. 507.

[3] State Bank *v.* Fox, 3 Blatchf. (U. S.) 431; Williams *v.* Savage Man. Co., 3 Md. Ch. 418. An agreement of a corporation to sell its own shares for less than their par value has been held valid, it not appearing how the company acquired the stock. Otter *v.* Brevoort Petroleum Co., 50 Barb. (N. Y.) 247.

[4] Rivanna Nav. Co. *v.* Dawsons, 3 Gratt. (Va.) 19; *s. c.* 46 Am. Dec. 183.

[5] Williams *v.* Savage Man. Co., 3 Md. Ch. 417.

[6] Ex parte Holmes, 5 Cow. (N. Y.) 426; Brewster *v.* Hartley, 37 Cal. 15; *s. c.* 99 Am. Dec. 237.

[7] Bank of Columbus *v.* Bruce, 17 N. Y. 507.

[8] *Ante*, § 2952.

tions are as much a part of the capital stock, which constitutes a *trust fund* for the security and benefit of creditors, as its tangible assets. It follows, and has been decided in almost every variety of situation, that any arrangement or manipulation which disperses this fund, or even converts it into common assets,[1] is void as against creditors who have given credit on the faith of it. And while a court of justice will probably uphold a compromise by which a company, solvent and paying dividends, receives its own stock in payment of a debt which it would otherwise lose,[2] yet an arrangement by which a company receives its own stock in discharge of notes given for stock subscriptions scatters this trust fund into air.

§ 3278. Want of Knowledge on Part of Transferor. — If a shareholder, in selling his shares, deals at arms-length with the company, and conveys them to a qualified person under circumstances which do not charge him with knowledge that the transferee is a mere trustee for the company, and he, in point of fact, has no such knowledge, the existence of such a fact will not avoid the transfer and make him a contributory.[3] The same rule has been applied where the shares were sold to a qualified person through a broker, the vendor having no knowledge of the fact that the transferee received them in trust for the company, or that they were purchased with the company's funds.[4] Thus, the deed of settlement of a banking company provided that shares might be transferred with the consent of the directors, but that the transfers should be registered, and that an indorsement of the registry should be made on the deed of

[1] Sawyer *v.* Hoag, 17 Wall. (U. S.) 610.

[2] Currier *v.* Lebanon Slate Co., 56 N. H. 262, 268, *per* Smith, J., and other cases cited *supra.* English cases depending upon *special circumstances*, which are set out at length in Thomp. Stockh., § 238, are: London &c. Bank *v.* Henry, L. R. 7 Eq. 334; Gray's case, 1 Ch. Div. 664; Saunder's case, 2 De Gex, J. & S. 101.

[3] Grady's case, 1 De Gex, J. & S. 488. The writer thinks that Lord Westbury was wrong in inferring from the facts of this case that the transferor was without knowledge of the trusteeship of the transferee. This, however, does not alter the principle on which the case proceeded.

[4] Nicol's case, 3 De Gex & J. 387; Johnston *v.* Laflin, 5 Dill. (U. S.) 65; *s. c.* affirmed, 103 U. S. 800.

transfer, and should be sufficient evidence of the directors' consent. A shareholder placed his shares in the hands of a broker, and they were sold, nominally, to the solicitor of the company, but really (though without the knowledge of the shareholder) to the company itself, the purchase-money being paid out of the company's funds, and the subsequent dividends being carried to their credit. On these facts the court held that, although there was no indorsement on the transfer to the solicitor, the directors' consent was sufficiently proved, and that, on the company being wound up, the vendor ought not to be placed on the list of contributories as a present shareholder.[1] A holder of full-paid shares of stock in a national bank employed a broker to sell the same in the market. The broker, without the stockholder's knowledge or direction at the time, sold the same at their market value to the president of the bank, individually, and received in payment his individual check on the bank for the purchase price, and delivered to the purchaser the share certificates assigned in blank, with blank powers of attorney thereon indorsed, authorizing the transfer of the shares upon the books of the bank. Subsequently, after the amount of the check had been collected, but on the same day, the president, without the knowledge of the stockholder or his broker, directed the book-keeper of the bank to credit his individual account with the amount of the check which he had given for the shares, and to transfer the shares (the book-keeper inserting his own name in the blank power of attorney to make the transfer) to him as "trustee": not specifying for whom he was trustee, and charging the sum to the "sundry stock account" of the bank; all of which was done. The bank, although it had not committed any act of insolvency, was then insolvent; but this fact was not known by the stockholder or the broker. The court held that, although the bank, or its officers for it, was prohibited from purchasing its own shares,[2] yet that the stockholder, having sold in good faith, without notice of the

[1] Nicol's case, 3 De Gex & J. 387.

[2] U. S. Rev. Stats., § 5201.

illegal purpose of the president in buying the stock, or of his intended misappropriation of the funds of the bank in paying therefor, was not liable to pay back to the receiver of the bank the money received in payment of the shares.[1]

§ 3279. Transfer to a Non-existent or Fictitious Person. — It is not necessary to do more than state the proposition that a shareholder cannot escape the obligation of performing his contract of subscription by the device of transferring his shares to a fictitious or non-existent person, under the theory that he has thus *abandoned* his shares.[2]

ARTICLE V. EXONERATION OF THE TRANSFEROR.

SECTION
3283. General rule that who is a shareholder determined by the corporate books.
3284. General rule that transferor is liable while his name remains on the books.
3285. View that transferor is relieved unless guilty of negligence.
3286. Illustrations of this view.
3287. This view denied in Ohio.
3288. Rule where the transferor is a director.
3289. Corporation may waive formality in the transfer.
3290. Where the transfer is to the corporation itself.
3291. Prohibited transfers.
3292. Where the transferor owns and transfers all the shares.
3293. Statutory provisions respecting notice of transfer.
3294. Statutory provisions avoiding transfers made within a given time prior to the failure of the corporation.
3295. Period at which transfer inoperative to divest liability.
3296. Where the liability is for rent accruing after transfer under a lease made before transfer.
3297. When transferor cannot impeach validity of transfer.

[1] Johnston *v.* Laflin, 5 Dill. (U. S.) 65; *s. c.* affirmed, 103 U. S. 800. The writer maintains the position taken in his work on stockholders (Thomp. Stockh., §§ 239, 240), that this decision is fundamentally erroneous, in that it ignores the primary fact that an insolvent corporation has *no power* to dispose of its assets in exchange for its own shares, and that no number of innocent intermediaries, and no amount of stock-jobbing hocus-pocus ought to be allowed to create such a power. The fact that the stockholder, who thus obtained, without rendering any lawful consideration, a portion of the assets which the law had impressed with a trust in favor of the creditors of the corporation, may have been innocent, furnishes no reason whatever why he should not restore those assets to the receiver of the corporation. He would have no higher rights than an innocent purchaser from a bailee or trustee would have, where the latter has no power to sell.

[2] Muskingum Valley Turnp. Co. *v.* Ward, 13 Ohio, 120; *s. c.* 42 Am. Dec. 191.

§ 3283. General Rule that Who is a Shareholder Determined by the Corporate Books.—The general rule already noticed,[1] then, is, that every person whose name, by his authority, has been *placed on the books* of a corporation as a shareholder, is such, both as to the corporation[2] and to its creditors, so long as his name remains there.[3] He may hold the shares as trustee for others,[4] or for the company itself,[5] or as collateral security for money loaned;[6] and yet, he is personally liable as a shareholder, and if he suffers loss in consequence of his position, he must seek indemnity from the equitable owner.[7] So, although he may have sold his shares to another, and received pay for them, and delivered to the purchaser his certificate,—yet until the transfer has been perfected by registering the transfer on the corporate books, as required by the charter, statute, articles of association, or deed of settlement governing the company, the transfer, though valid as between him and the transferee,[8] does not

[1] *Ante*, § 3193.

[2] *Ante*, § 2387.

[3] State *v.* Ferris, 42 Conn. 560; Skowhegan Bank *v.* Cutler, 49 Me. 315; Re Empire City Bank, 18 N. Y. 199, 200; *s. c.* 6 Abb. Pr. (N. Y.) 385; Holyoke Bank *v.* Burnham, 11 Cush. (Mass.) 183; Crease *v.* Babcock, 10 Met. (Mass.) 525; Grew *v.* Breed, 10 Met. (Mass.) 569; Stanley *v.* Stanley, 26 Me. 191; Worrall *v.* Judson, 5 Barb. (N. Y.) 210; Fowler *v.* Ludwig, 34 Me. 455.

[4] Mitchell's case, L. R. 9 Eq. 363; Holt's case, 1 Sim. (N. S.) 389; Ind's case, L. R. 7 Ch. 485; *ante*, § 3194.

[5] Chapman's case, L. R. 3 Eq. 361; Hoare's case, 2 Johns. & H. 229; Ex parte Oriental Com. Bank, L. R. 3 Ch. 791; Hemming *v.* Maddick, L. R. 9 Eq. 175; *s. c.* L. R. 7 Ch. 395; *ante*, § 3196.

[6] Adderly *v.* Storm, 6 Hill (N. Y.), 624; Rosevelt *v.* Brown, 11 N. Y. 148; Re Empire City Bank, 18 N. Y. 199, 223; Holyoke Bank *v.* Burnham, 11 Cush. (Mass.) 183; Magruder *v.* Colston, 44 Md. 349; *s. c.* 22 Am. Rep. 47; Crease *v.* Babcock, 10 Met. (Mass.) 525, 545; Wheelock *v.* Kost, 77 Ill. 296; Pullman *v.* Upton, 96 U. S. 328; Simmons *v.* Hill, 96 Mo. 679; *s. c.* 2 L. R. A. 476; *ante*, §§ 2937, 3213.

[7] Ex parte Oriental &c. Bank, L. R. 3 Ch. 791; Hemming *v.* Maddick, L. R. 9 Eq. 175; *s. c.* L. R. 7 Ch. 395; Stover *v.* Flack, 30 N. Y. 64.

[8] Johnson *v.* Underhill, 52 N. Y. 203; Duke *v.* Cahawba Nav. Co., 10 Ala. 82; *s. c.* 44 Am. Dec. 472; Shepherd's case, L. R. 2 Ch. 16; Sheffield &c. R. Co. *v.* Woodcock, 2 Railw. Cas. 522; Castellan *v.* Hobson, L. R. 10 Eq. 47; Hall *v.* United States Ins. Co., 5 Gill (Md.), 484; Chouteau Spring Co. *v.* Harris, 20 Mo. 382; St. Louis Perpetual Ins. Co. *v.* Goodfellow, 9 Mo. 149; Moore *v.* Bank of Commerce, 52 Mo. 377, 379; Gilbert *v.* Manchester Co., 11 Wend. (N. Y.) 627; Bank of Utica *v.* Smalley, 2 Cow. (N. Y.) 770; *s. c.* 14 Am. Dec. 526; Quiner *v.* Mar-

divest his liability as a shareholder to the company[1] or to its creditors.[2]

§ 3284. General Rule that Transferor is Liable while His Name Remains on the Books. — The registration being intended in part for the protection of the public,[3] one who has parted with his shares, and yet suffers his name to remain on the register, remains a stockholder by *conduct* or *estoppel*, upon familiar grounds already discussed.[4] And where the governing statute provides that transfers can only be made by deed and by alteration of the register, and a shareholder transfers his shares in another way, although the company may recognize

blehead Social Ins. Co., 10 Mass. 476; Sargent *v.* Essex R. Co., 9 Pick. (Mass.) 202; Nesmith *v.* Washington Bank, 6 Pick. (Mass.) 324; Sargent *v.* Franklin Ins. Co., 8 Pick. (Mass.) 90; *s. c.* 19 Am. Dec. 306; McEuen *v.* West London &c. Co., L. R. 6 Ch. 655; Brigham *v.* Mead, 10 Allen (Mass.), 245; Shaw *v.* Rowley, 16 Mees. & W. 810; Walker *v.* Bartlett, 36 Eng. L. & Eq. 368; *s. c.* 18 Com. B. 845; *ante*, § 2389. An assignment not made in conformity with the law governing the corporation will pass an equitable title, which will bind all persons having notice of it. Black *v.* Zacharie, 3 How. (U. S.) 483.

[1] Helm *v.* Swiggett, 12 Ind. 196; Coleman *v.* Spencer, 5 Blackf. (Ind.) 197; New Albany &c. R. Co. *v.* McCormick, 10 Ind. 499; *s. c.* 71 Am. Dec. 337; Marlborough Man. Co. *v.* Smith, 2 Conn. 579.

[2] Shellington *v.* Howland, 53 N. Y. 371; Worrall *v.* Judson, 5 Barb. (N. Y.) 210; Dane *v.* Young, 61 Me. 160; Wehrman *v.* Reakirt, 1 Cin. Sup. (Oh.) 230, 237; Marino's case, L. R. 2 Ch. 596; Musgrave & Hart's case, L. R. 5 Eq. 695; Walker's case, L. R. 6 Eq. 30; McEuen *v.* West London &c. Co., L. R. 6 Ch. 655. *Contra*, Wehrman *v.* Reakirt, 1 Cin. Sup. (Oh.) 230, 237. Compare Eames *v.* Wheeler, 19 Pick. (Mass.) 442. As to the *conclusiveness of the public registry* of shares under *English statutes*, see Thomp. Stockh., § 219, where the following cases are examined: Dossett *v.* Harding, 1 Com. B. (N. S.) 524; Fry *v.* Russell, 3 Com. B. (N. S.) 665; Powis *v.* Butler, 3 Com. B. (N. S.) 645; affirmed in Ex. Ch. 4 Com. B. (N. S.) 469; Powis *v.* Harding, 1 Com. B. (N. S.) 533; Henderson *v.* Royal British Bank, 7 El. & B. 356; Daniell *v.* Royal British Bank, 1 Hurl. & N. 681.

[3] The rule is intended for the benefit of the company also (*ante*, § 2387); and hence, as between the transferee and the company, unless his own transfer is made upon the books of the company, he is not a stockholder. The mere fact that he owns the certificate of stock does not make him a stockholder. Helm *v.* Swiggett, 12 Ind. 194, 196; Coleman *v.* Spencer, 5 Blackf. (Ind.) 197; New Albany &c. R. Co. *v.* McCormick, 10 Ind. 499; *s. c.* 71 Am. Dec. 337; Marlborough Man. Co. *v.* Smith, 2 Conn. 579.

[4] *Ante*, § 1877, *et seq.*; Re Reciprocity Bank, 22 N. Y. 9; Plumb *v.* Bank of Enterprise, 48 Kan. 484; *s. c.* 29 Pac. Rep. 699.

the transfer by receiving assessments from the transferee, this, it has been held in England, does not discharge the transferor from liability to the company as a shareholder. If this were not so, the wholesome requirement of the law might be entirely eluded; and any person who examined the register, whether a creditor who wished to know the names of the shareholders, or a shareholder who wished to know the names of his co-shareholders, would be entirely deceived.[1] The general rule therefore is, that where the governing *statute* or the *by-laws* of the company require that transfers of its shares shall be noted on the books of the company, or, as it is expressed in most charters, that the shares shall be *transferable on the books* of the company,—then, unless the transfer is so registered on the company's books, the transferor remains liable to the creditors of the company in the event of its insolvency, although, as between him and the transferee, the transfer may have been out-and-out.[2] And it makes no difference, for the purposes of this rule, whether or not the stock stood on the books of the corporation in the name of some other person as his *trustee*.[3] Nor will a *private agreement* between the transferor and transferee, that the former shall not be liable, relieve him from such liability.[4] In this respect, the English rule coincides for the most part with the American rule, and where the constitution of a company requires that a transfer of shares be executed by both parties, and it is not executed by the transferee, the English courts will not, under sections 35 and 98 of the Companies Act, 1862, *rectify the register*, but will put the transferor on the list of contributories, and leave the transferor and transferee to their remedies against each other.[5]

[1] McEuen *v.* West London &c. Co., L. R. 6 Ch. 655.

[2] *Ante*, § 2397; Fowler *v.* Ludwig, 34 Me. 455; Richmond *v.* Irons, 121 U. S. 27; Worrall *v.* Judson, 5 Barb. (N. Y.) 210; Irons *v.* Manufacturers' Nat. Bank, 27 Fed. Rep. 591; Force *v.* Dahlonega Fanning &c. Co., 22 Ga. 86; Borland *v.* Haven, 37 Fed. Rep. 394 (under Cal. Code); Bell's Appeal, 115 Pa. St. 88; *s. c.* 2 Am. St. Rep. 532; Wright *v.* Steinkemeyer, 6 Mo. App. 575.

[3] Borland *v.* Haven, 37 Fed. Rep. 394.

[4] Bell's Appeal, 115 Pa. St. 88; *s. c.* 2 Am. St. Rep. 532; 8 Atl. Rep. 177; 7 Cent. Rep. 159, 160; 11 East. Rep. 608, 665.

[5] Marino's case, L. R. 2 Ch. 596; Musgrave & Hart's case, L. R. 5 Eq. 193.

§ 3285. View that Transferor is Relieved unless Guilty of Negligence.—In England, subject to the exception of one year's time in the Companies Act, 1862, the transferor will not be liable as a contributory, unless his name was suffered to remain on the register through his *negligence.*[1] It is believed that the qualification put upon it by Sir John Romilly, M. R., that where the transferor has done all in his power to complete the formality of the transfer he is discharged from liability as a shareholder,[2] cannot be successfully objected to; and the rule now obtaining in England seems even less stringent: a transferor who has negligently suffered his name to remain on the register will be held as a contributory,[3] but one whose name remains there notwithstanding he has been guilty of no *laches* will not.[4] This view has been adopted by *the courts of the United States,* at least in respect of transfers of shares of national banking corporations. But it is supposed that the principle on which those courts proceed is equally applicable to other corporations. That rule is, that where the shareholder, in selling his shares, does all that a careful and prudent business man should do to discharge himself from liability as a shareholder, he will not be held responsible for the neglect and carelessness of an officer of the bank in failing to register the transfer.[5] But, while recognizing this principle, it has been held that a stockholder, who, after sale of his stock, permits his name to remain on the books of the corporation as a stockholder, and knows, or should know, the common usage of the corporation as to the

[1] Shortridge *v.* Bosanquet, 16 Beav. 84; White's case, L. R. 3 Eq. 86; Ward's case, L. R. 2 Eq. 226; Ex parte Henderson, 19 Beav. 107; Fyfe's case, L. R. 4 Ch. 768; Nation's case, L. R. 3 Eq. 77; Hill's case, L. R. 4 Ch. 769, note; Ward & Garfit's case, L. R. 4 Eq. 189.

[2] Shortridge *v.* Bosanquet, 16 Beav. 84; White's case, L. R. 3 Eq. 86; Ward's case, L. R. 2 Eq. 226; Ex parte Henderson, 19 Beav. 107. But see Bosanquet *v.* Shortridge, 4 Ex. 699.

[3] Head's case, L. R. 3 Eq. 84; White's case, L. R. 3 Eq. 86; Walker's case, L. R. 6 Eq. 30; Shepherd's case, L. R. 2 Ch. 16.

[4] Fyfe's case, L. R. 4 Ch. 768; Nation's case, L. R. 3 Eq. 77; Hill's case, L. R. 4 Ch. 769, note; Ward & Garfit's case, L. R. 4 Eq. 189.

[5] Hayes *v.* Shoemaker, 6 Rail. & Corp. L. J. 324; *s. c.* 39 Fed. Rep. 319; Hayes *v.* Yawger, 39 Fed. Rep. 912; Whitney *v.* Butler, 118 U. S. 655; Young *v.* McKay, 50 Fed. Rep. 394.

recording of transfers, cannot complain that *no by-law has been enacted* prescribing the manner of transfer, nor claim exemption from individual liability on that ground, because of his negligence.[1] In another court, where this principle is recognized, a stockholder in a national bank, in good faith, and without any expectation of the insolvency of the bank, sold his stock, but no transfer was made on the books until after the bank had become insolvent and gone into liquidation. It was held that he continued liable under the statute for the debts of the bank, in respect of such stock, so long as it was not transferred on the books of the bank, or the certificate was not delivered *to the bank* with a power of attorney and a request for the making of such transfer; and such delivery *to the president* of the bank, not as president, but as purchaser of the stock, did not discharge the stockholder.[2]

§ **3286. Illustrations of This View.** — A holder of national bank shares sold them in good faith. The failure to have the transfer made on the bank books was due to the *negligence of the cashier*, who had been told to make it, and who had promised to do so. It was held that the seller was not liable to an assessment ordered by the Comptroller of the Currency on the subsequent failure of the bank.[3] In another case it appeared that A., an owner of shares in the capital stock of a national bank, employed an auctioneer to sell them at public auction. They were bid off by B., who paid the auctioneer for them, and received from him the certificate of stock, with a power of attorney for transfer duly executed in blank. The auctioneer paid the purchase-money to A. B. was employed by the president of the bank to make this purchase for a customer of the bank, who had made a deposit in the bank for the purpose, and he *delivered the certificate and the power of attorney to the president*, and received from the bank the money for the purchase. No formal transfer of the stock was made on the transfer books of the bank. Shortly afterwards the bank became insolvent, and eventually went into the hands of a receiver, who made an assessment on the stockholders under the provisions of Rev. Stats. U. S., § 5205, to make up the deficiency in the capital. Until

[1] Plumb *v.* Bank of Enterprise, 48 Kan. 484; *s. c.* 29 Pac. Rep. 699.

[2] Richmond *v.* Irons, 121 U. S. 27.

[3] Hayes *v.* Shoemaker, 39 Fed. Rep. 319; 17 Wash. L. Rep. 633; *s. c.* 6 Rail. & Corp. L. J. 324.

after the stoppage A. had no knowledge as to the purchaser, or as to the neglect to formally transfer the stock, and no reason to suppose that the transfer had not been made. In an action against A., by the receiver, to recover the amount of the assessment upon his stock, it was held that the responsibility of A. ceased upon the surrender of the certificates to the bank, and the delivery to its president of a power of attorney sufficient to effect, and intended to effect, as the president knew, a transfer of the stock on the books of the bank.[1] In an action by the receiver of a national bank to enforce an assessment under Rev. Stats. U. S., § 5151, against one whose name stood on the transfer books as a stockholder, it appeared that nearly a year before the failure of the bank he had sold his stock to a broker for an undisclosed principal; that he indorsed the same, and requested the broker to inform the cashier of the transaction, and to have the stock transferred; that the broker accordingly handed the stock to the cashier, gave him the necessary information, and requested him to make the transfer. This the cashier promised to do, but in fact the transfer was never made. The certificate recited that it was transferable on the books of the company "by indorsement hereon and surrender of this certificate." It was held that, in requesting the cashier to make the transfer, the broker acted as the seller's agent, and that the latter did all that was required of him as a prudent business man, and could not be held liable as a stockholder.[2] This view has also been taken in face of a statute which provides that "no transfer of stock shall be valid for any purpose whatever, except to render the person to whom it shall be transferred liable for the debts of the corporation according to the provisions of this act, until it shall have been entered" in a book referred to "by an entry showing from and to whom transferred."[3] There was also a by-law of the company providing that transfers of shares should "only be made, on the books of the company," in the manner therein directed. In an action to charge one who had been a holder of eighty shares of the stock of the company, and also one of its directors, with personal liability for one of its debts, by reason of a failure on the part of the directors to file an annual report required by another section of the statute,[4]

[1] Whitney *v.* Butler, 118 U. S. 655; reversing Price *v.* Whitney, 28 Fed. Rep. 297.

[2] Young *v.* McKay, 50 Fed. Rep. 394.

[3] New York Act of 1875, ch. 611, § 17.

[4] *Ibid.*, § 18.

it appeared that the defendant, prior to the period of default in filing the report, desiring to sever his connection with the company, went to Latimer E. Jones, its secretary and treasurer, and also to one Atchinson, an employé of the company, and asked for his share certificate, which he indorsed, as follows, over his signature: "For value received, I hereby sell, transfer, and assign to Latimer E. Jones eighty shares of stock within mentioned, and authorize L. E. Jones to make the necessary transfer on the books of the company. Witness my hand and seal this fifth day of November, 1885. A. W. Colwell." He then delivered his share certificate with this indorsement to Jones, announcing that it severed his connection with the company, and that he had nothing further to do with it. Jones accepted the certificate, and the defendant asked for the transfer book, but the company did not have one, and he was told that it was not necessary. Some days later, however, a transfer book was obtained, and, as we understand the case, a formal transfer was made thereon of seventy-five of the shares to Jones, who issued a new certificate to himself for that number; but, at the suggestion of Atchinson, and without the knowledge of the defendant, a certificate for the remaining five shares was reissued to the defendant, *and he was induced a few days later to accept it*, though with the understanding that he should not continue to be a director. On this state of facts the Court of Appeals of New York held that the defendant was neither chargeable as a director by reason of having been such when the default occurred, nor as a shareholder; because what he had done had operated to divest him of all his shares prior to the period of the default, and his ownership of them had not been resumed.[1] Unless there is some inaccuracy in the foregoing statement of facts, the decision is a palpable aberration, and it is entirely answered by a single sentence in the opinion of Bradley, J., who dissented: "The defendant owned *eighty* shares of the stock, and no more than *seventy-five* of them were transferred upon the books of the company; and, as between him and it, his relation of stockholder of five shares continued."[2]

§ **3287. This View Denied in Ohio.** — In Ohio the severe rule seems to obtain that if a man's name is once lawfully placed on the register of a company as a stockholder, he remains such until he

[1] Chemical Nat. Bank *v.* Colwell, 132 N. Y. 250; *s. c.* 43 N. Y. St. Rep. 876; 30 N. E. Rep. 644; reversing *s. c.* 9 N. Y. St. Rep. 285, 288.

[2] *Ibid.*, 132 N. Y. 250, 258.

gets it off, and that he must see to it that it is got off, or he will be compelled to respond to creditors. The vendor of corporate stock was held liable under a statute of that State to the creditors of the corporation who became such after his *transfer*, where he still appeared by the stock book to be the owner of the shares, notwithstanding the sale was made in good faith, and for value, and that the purchaser was treated by the company as the owner of the stock, and the vendor made an attempt to have it transferred on the books, which transfer failed because of the *neglect of the secretary* of the company. It was held that the vendor would be charged with such neglect.[1]

§ 3288. Rule where the Transferor is a Director. — The rule which requires the transferor to see to it that the name of the transferee is substituted for his on the books of the company seems to apply without exception where the transferor is a *director*. He is in a very different position from that of an ordinary shareholder, for he has the means of seeing that all the formalities of transfer required by the constitution of the company are complied with, and he is therefore bound, in transferring his shares, to see to the regularity of the transfer. If he fails in this, he remains a contributory.[2] The same principle has been applied where the auditor of a failing company transferred his shares to the managing director under circumstances of doubtful good faith, and where the requisite formalities were not attended to.[3]

§ 3289. Corporation may Waive Formality in the Transfer. — It is shown elsewhere that the *by-laws* and *statutes* which require transfers to be made on the books of the corporation

[1] Harpold *v.* Stobart, 46 Ohio St. 397; *s. c.* 15 Am. St. Rep. 618; 21 N. E. Rep. 637.

[2] Ex parte Brown, 19 Beav. 97. There is one untenable decision to the contrary: Chemical Nat. Bank *v.* Colwell, 132 N. Y. 250; *ante*, § 3286.

[3] Ex parte Henderson, 19 Beav. 107. "*Rectifying the register*" under English Companies Act, 1862, § 35: Lowe's case, L. R. 9 Eq. 589; Nation's case, L. R. 3 Eq. 77; Fyfe's case, L. R. 4 Ch. 768; Hill's case, *Id.* 769, note; Ward's case, L. R. 2 Eq. 226; Lind. Comp., 5th ed., pp. 61, 748, 755, 832, 834. Where name wrongly on register in first instance: Fox's case, L. R. 5 Eq. 118; Walker's case, L. R. 6 Eq. 34; Rivington's case, 3 Ch. Div. 10; Doman's case, 3 Ch. Div. 21.

prescribe a *rule for the benefit of the corporation.*[1] It is perhaps no more than a different statement of the doctrine of the preceding section to say that the corporation has power to *waive* such a provision, and that if the corporation does waive it at the request of a purchaser of the stock, or with his assent, he becomes a stockholder, and directly liable for future assessments.[2] On a similar principle, the corporation may be *estopped*, by its *conduct* in recognizing the transferee as a member, from afterwards enforcing a *call* against the transferor. When, therefore, a stockholder in a corporation transferred his stock in good faith, but did not cause the transfer to be made upon the books of the company, as required by the statute of incorporation, and the company had no transfer book, and the certificate required to be filed and recorded in the town clerk's office was not signed by the officers of the company, as required by its by-laws, but was recorded by the direction of the company, who acquiesced and recognized the transferee as the owner of the stock,—it was held that the original stockholder was not liable to pay calls upon the stock after the transfer.[3] So far as the corporation itself is concerned, it cannot be permitted to derive an advantage from its own negligence or other fault, but it is bound to recognize the title of the transferee, and consequently to exonerate the transferor exactly as though it had done its duty in the premises.[4] So, also, in an action by a receiver of the corporation against a past shareholder to recover an unpaid balance in respect of his shares, it appeared that the defendant sold certain stock of the corporation and executed a transfer thereof in blank, which was subsequently delivered to the purchasers, a firm composed of the president and one of the trustees of the corporation, who, for four years thereafter, were paid by the corporation the dividends on the stock, and the payments were placed to the credit of the firm by the company, though the transfer was not, nor was it

[1] *Ante*, § 2387, *et seq.*

[2] Upton *v.* Burnham, 3 Biss. (U. S.) 431.

[3] Isham *v.* Buckingham, 49 N. Y. 216. See, also, Billings *v.* Robinson, 49 N. Y. 415, 420; affirming *s. c.* 28 Hun (N. Y.), 122.

[4] *Ibid.*; Robinson *v.* National Bank, 95 N. Y. 637; Central Nat. Bank *v.* Williston, 138 Mass. 244.

required by law to be, entered upon the books of the company. It was held (reversing the Supreme Court) that the defendant was not liable, as his vendees acquired all his title to the stock, and the corporation had recognized them as the owners; and that the plaintiff, as receiver of the corporation, possessed only the rights of the corporation, and got no title which authorized him to claim payment of the stock from the former owner.[1]

§ 3290. Where the Transfer is to the Corporation Itself. Where the transfer is *in form* to the corporation itself, and the question of the *status* of the transferor arises between him and the corporation, whether he will be regarded as a member or not will be a question of fact and intent, to be determined upon a consideration of what the parties did, agreed, and intended. Thus, a stockholder of a bank transferred his shares to the corporation by a writing absolute in form, and surrendered his certificate of stock, and at the same time left with the cashier an agreement, in which, after reciting that he had transferred the shares *as collateral security* for the payment of a certain note in bank, he covenanted that if the note should not be duly paid, the bank might sell the shares and apply the proceeds to the payment of the note, and hold the surplus to his use. He paid interest from time to time upon the note after it had fallen due, and continued to receive the dividends upon the shares. On these facts, it was held that he was still a member of the corporation.[2]

§ 3291. Prohibited Transfers.—If the constitution or governing statute of a joint-stock company exacts a condition precedent to a valid transfer of shares, as, that the *consent of the directors* shall have been obtained, or that the transferor shall have paid all assessments,[3] a transfer without the performance of this condition, not being good between the transferor and

[1] Cutting *v.* Damerel, 88 N. Y. 410, 411; reversing *s. c.* 23 Hun (N. Y.), 339.

[2] Merchants' Bank *v.* Cook, 4 Pick. (Mass.) 405.

[3] Gilbert's case, L. R. 5 Ch. 559.

the company, leaves him, of course, liable to its creditors.[1] If, however, this condition precedent is exacted, not by the constitution of the company, but by a *by-law* merely, it may be *waived* by a contrary *usage* on the part of the company. Thus, where a by-law required the consent of the directors to a transfer of stock by a person indebted to the company, but in the practice of the company such cases were never brought before the board, a transfer by such a stockholder, made without their consent, but according to the usage of the company, was good against the company.[2]

§ 3292. **Where the Transferor Owns and Transfers all the Shares.** — Cases where all the shares in the corporation are owned by one person have given the courts some embarrassment.[3] It must be kept in mind that where all the shares of stock of a corporation pass into the ownership of one person, the corporation is not thereby *ipso facto* dissolved, nor its stock merged, so to speak, so as to make him the legal owner of the tangible property of the corporation. But he is the *equitable owner* of it; and if he undertakes to convey it, equity, which looks through the form to the substance of things, will give effect to his conveyance as an equitable deed or mortgage, as the case may be.[4] In one such case A. owned all the stock of a banking corporation, which owed no debts. A. was about to wind up his business, when others induced him to transfer the charter to them. A. transferred the stock to these persons without consideration, and took all of the property belonging to the bank, giving notice of the transfer of the stock under the statute. The new owners paid in more than the amount of the property before the transfer. Everything was done in good faith. It was held that subsequent creditors had no rights as against A.[5]

[1] Bosanquet *v.* Shortridge, 4 Ex. 699; Walker's case, L. R. 2 Eq. 554. But see Shortridge *v.* Bosanquet, 16 Beav. 84; Straffon's Executor's case, 1 De Gex, M. & G. 576; Sadler's case, 3 De Gex & S. 36.

[2] Chambersburg Ins. Co. *v.* Smith, 11 Pa. St. 120.

[3] *Ante*, § 2946.

[4] Swift *v.* Smith, 65 Md. 428; *s. c.* 57 Am. Rep. 336; 5 Atl. Rep. 434; 3 Cent. Rep. 899; 6 East. Rep. 574.

[5] Morgan *v.* Brower, 77 Ga. 627.

§ 3293. Statutory Provisions Respecting Notice of Transfer. — Upon principles already announced, it is obvious that if the governing statute exacts that a transferor of stock shall give *public notice* of the transfer in a prescribed manner, a person transferring his shares cannot escape liability to creditors without showing affirmatively that such notice was given. It was so held where the section of a statute relating to the transfer of shares contained the proviso that "such stockholders shall give notice once a month, for six months, of such transfer, immediately thereafter, in two newspapers in or nearest to the place where such bank or corporation shall keep the principal office."[1] But where the charter of a bank rendered stockholders liable, after a transfer of stock, unless sixty days' notice of the sale had been given in one of the public gazettes of the State, and provided the transfer had been made six months before the failure of the corporation, all the stockholders who had given notice in the terms of the act were exempt, unless the failure had occurred within six months thereafter, and all other stockholders were liable for the redemption of the bills, whether they had transferred their shares or not.[2]

§ 3294. Statutory Provisions Avoiding Transfers Made within a Given Time Prior to Failure of Corporation.— Under a statutory provision that "all transfers of stock in said bank shall be wholly void if made within six months previous to the failure of the said bank," the refusal of the bank to redeem its paper in gold and silver was such a "*failure*" as avoided all transfers of stock made within six months before the refusal; nor was it necessary that the insolvency of the bank should be judicially ascertained to establish the fact of failure for this purpose.[3] But the *resumption of specie payments*, under the healing operation of another statute, cured such failure, so as to restore the rights of the parties to such transfers of stock to what they would have been had there been no failure.[4]

[1] Force *v.* Dahlonega &c. Co., 22 Ga. 86; Mason *v.* Force, 30 Ga. 99.

[2] Lane *v.* Morris, 8 Ga. 468.

[3] Lumpkin *v.* Jones, 1 Ga. 27.

[4] *Ibid.*

§ 3295. Period at Which Transfer Inoperative to Divest Liability. — The principles governing the subject of which we are now speaking, if it can be said to have any governing principles, have been considered in a former chapter.[1] Under the Missouri statute, creditors may bring their actions "against any person or persons who were stockholders *at the time of such dissolution*," meaning a dissolution of the corporation. An assignment by a corporation of all its assets is, for the purposes of this statute, deemed a dissolution; and where a stockholder executed a pledge of his stock after such an assignment by the corporation of its assets, he remained, notwithstanding such pledge, liable to actions by creditors of the corporation in respect of any amount due by him to the corporation on account of his shares.[2] As the individual liability is repealed, the rule is the same in respect of the liability for unpaid shares. In Maine, the holder of stock in a corporation is not liable for the corporate debts, at the suit of a creditor, as to stock subscribed for by him which he had transferred before such creditor's cause of action against the corporation was contracted, or upon additional shares issued by the corporation as fully paid-up stock which he purchased in open market; but he is liable only to the extent of the amount unpaid upon shares originally subscribed for and retained by him.[3] In Rhode Island, under a statute providing that members of corporations shall be liable for the corporate debts *until the whole capital stock is paid in*, one who was a stockholder when the debt in question was contracted is liable, as is one who was a stockholder when the liability was enforced by legal process; but not one who became a stockholder after the debt was contracted, and ceased to be such before the liability was enforced.[4] Under a statute of Massachusetts, a member of a manufacturing company may be liable for the debts of the corporation contracted while he was a member, although he ceased to be such before the debts became pay-

[1] *Ante*, § 3169, *et seq.*

[2] Kehlor *v.* Lademann, 11 Mo. App. 550.

[3] Libby *v.* Toby, 82 Me. 397; *s. c.* 19 Atl. Rep. 904.

[4] Sayles *v.* Bates, 15 R. I. 342.

able; but he is not liable for debts contracted before he became a member, if his membership expires before the debts become payable.[1] In Ohio, a stockholder who, in good faith, sells and transfers his stock to one who afterwards becomes insolvent, is liable to creditors of the corporation for *such portion only of the debts* existing while he held the stock, and remaining due (not in excess of its amount), as will be equal to the proportion which the capital stock assigned by him bears to the entire capital stock held by solvent stockholders within the jurisdiction, liable in respect of the same debts, to be ascertained at the time judgment is rendered.[2]

§ 3296. Where the Liability is for Rent Accruing after Transfer under a Lease Made before Transfer. — Where land was leased to a corporation, the stockholders of which were liable, under a statute of Massachusetts,[3] after ceasing to be such, for any debt contracted by such corporation while they were such, or which might have accrued while they were stockholders, it was held that no action could be maintained against a stockholder for the rent of a quarter which commenced after he had sold out his shares, although the lease was executed before such sale; because rent does not accrue to the lessor as a debt until the lessee has enjoyed the use of the land.[4]

§ 3297. When Transferor cannot Impeach Validity of Transfer. — Where an insurance company took notes secured by mortgages from its members in payment of the first installment due upon its shares of stock, and afterwards went into liquidation, and, finding that it had enough to pay all demands, received back the stock certificates so issued, and surrendered up the notes and mortgages, and it appeared that one of those members had transferred his certificate in pledge to secure a liability to other parties, so that he was disabled from surrendering it to the company, and the com-

[1] Holyoke Bank *v.* Burnham, 11 Cush. (Mass.) 183.

[2] Harpold *v.* Stobart, 46 Ohio St. 397; *s. c.* 15 Am. St. Rep. 618; 21 N. E. Rep. 637; 29 Cent. L. J. 110; 21 Week. L. Bul. 407.

[3] Mass. Stat. 1826, ch. 137, § 1.

[4] Bordman *v.* Osborn, 23 Pick. (Mass.) 295.

pany afterwards proceeded against him to foreclose the mortgage,— it was held that he could not set up the irregularity of the transfer by him to his pledgee for the purpose of sustaining his right of returning the certificate to the company.[1]

ARTICLE VI. LIABILITY OF THE TRANSFEREE.

SECTION
3301. Transferee may be liable notwithstanding informality of transfer.
3302. Transfers to the transferee without his consent.
3303. What will not be evidence of such consent.
3304. Error in distinguishing the numbers of the shares not material.
3305. Not necessary that the new certificate should have issued to the transferee.
3306. Transferee liable without reference to the motive of the transfer.
3307. Retransfer in pursuance of a previous agreement.
3308. Vendor in unregistered transfer may recover over against vendee.
3309. Liability to pay assessments as between vendor and purchaser.
3310. Transfer how proved to make transferee liable.
3311. Point of time at which liability attaches to transferee.
3312. Shares transferable free from liability when it has been exhausted.
3313. Purchasers at execution sale.

§ 3301. **Transferee may be Liable Notwithstanding Informality of Transfer.**—It does not follow, from what has preceded, that the transferee of shares can escape liability in consequence of informalities attending the transfer. If the transaction is good in substance, and he has treated himself as a shareholder, and has been treated as such by the directors, he, upon grounds already discussed,[2] makes himself a shareholder by *conduct*, and hence a contributory.[3] Thus, it has been held that the transferee, in a transfer not made in conformity with the by-laws, may become fixed with liability in his new relation, if he has been *recognized as a member* by the company, and registered as such, of which recognition slight evidence will be sufficient. This conclusion is placed on the ground that a provision in the by-laws of a company, requiring transfers

[1] Home Stock Ins. Co. *v.* Sherwood, 72 Mo. 461.

[2] *Ante*, § 1877, *et seq.*

[3] Straffon's Executor's case, 1 De Gex, M. & G. 576. But see Skowhegan Bank *v.* Cutler, 49 Me. 315; Upton *v.* Burnham, 3 Biss. (U. S.) 431; *s. c. Ibid.*, 520.

of its stock to be made only on its books, is for the benefit of the company, and may be *waived* by it; and if waived at the request of the transferee, or with his assent, he becomes a stockholder, and directly liable to future assessments.[1] So, it has been held that, while it may be true that a *national banking association* may not be bound to admit a purchaser of its shares to all the rights and liabilities of the prior holder, until he has caused the transfer to be regularly made on its books in the manner prescribed by its articles of association or by-laws—yet, when it does recognize him as the owner of the shares, by issuing new certificates to him without first observing its by-laws, so far as the registry of his name on its books is concerned, he will be subject to the liabilities of a shareholder, in the event of the insolvency of the bank.[2] There are other cases which seem to recognize this principle of the vendee of shares being drawn into privity with the corporation by a *recognition* by the corporation of his *status* as a member, although the transfer of the shares may not have been formally made to him on the books of the company;[3] whilst there are other holdings which exclude the liability of the vendee, even to the company, where, on the facts, the principle of recognition might possibly have been applied.[4] But as it would be utterly illogical, and even unjust, to hold both the transferor and transferee liable at the same time as the owners of the same shares, the foregoing rule operates, in the absence of fraud,[5] of circumstances raising estoppels,[6] and of statutory exceptions,[7] to prevent liability from attaching to

[1] Upton *v.* Burnham, 3 Biss. (U. S.) 431, opinion by Hopkins, J. But on the second trial of this case by the same court, before Blodgett, J., the question as to whether the transferee ever authorized, assented to, or waived the formal transfer of the stock to him, upon the books of the company, was held to be immaterial, and instructions to that effect asked by the defendant were refused. *Ibid.*, 520, *per* Blodgett, J.

[2] Laing *v.* Burley, 101 Ill. 591.

[3] See, for instance, Bell's Appeal, 115 Pa. St. 88; *s. c.* 2 Am. St. Rep. 532; *ante*, § 2388.

[4] Vale Mills *v.* Spalding, 62 N. H. 605; Cormac *v.* Western White Bronze Co., 77 Iowa, 32; *s. c.* 41 N. W. Rep. 480.

[5] *Ante*, § 3205.

[6] *Ante*, § 1877, *et seq.*

[7] *Ante*, § 3224, *et seq.* See N. Y. Laws of 1875, ch. 611, § 17.

the transferee until his name is entered as holder of the shares on the corporate books with his consent. Accordingly, the transfer, on the books of a corporation, of stock by persons holding it as *collateral security*, to one who had bid off such stock on execution against his debtor who had pledged it as collateral, did not make him liable as a stockholder, where such transfer was made without his request or knowledge. The fact that he had bid it off on execution does not, by implication, authorize such transfer.[1] So, in a case where, upon a sale of stock on execution, no certificate of the stock was called for or issued to the purchaser, but it remained standing on the books of the corporation in the name of the former owner, and he continued to vote upon it, with the presumed knowledge and assent of the corporation, it was held that the corporation could not enforce an assessment on the stock against the execution purchaser.[2] In another case, the holder of certain shares of stock agreed to sell them to B., and placed the certificate in the hands of a third person to be delivered to B. on payment of a note given for the purchase price. The note was never paid, and the shares remained on the books of the corporation in the name of the original holder. B. nevertheless voted, in respect of the shares, under a proxy, and the note was subsequently taken by the corporation, but not on account of any transaction between it and B. It was held that the transfer had not become complete in such a sense as to make B. liable to the corporation for unpaid assessments on the shares.[3]

§ 3302. Transfers to the Transferee without His Consent. — It takes two parties to make a contract; and a man cannot ordinarily be made the debtor of another, nor be forced into a new *status*, or loaded with new obligations, without his consent. Therefore, where shares are transferred to one without his consent, the transferee assumes no

[1] Simmons *v.* Hill, 96 Mo. 679; *s. c.* 2 L. R. A. 476.

[2] Vale Mills *v.* Spalding, 62 N. H. 605.

[3] Cormac *v.* Western White Bronze Co., 77 Iowa, 32; *s. c.* 41 N. W. Rep. 480.

liability as a shareholder,[1] unless he acquiesces in it or ratifies it, — as by receiving *dividends;*[2] or where he acquiesces in it after knowledge of the fraudulent purpose of assisting the transferor in defeating the creditors of the corporation.[3] Nor is the *record* of a transfer on the corporate books sufficient, without more, to charge the transferee for calls and assessments paid by the administrator of the original shareholder, the transferee denying that he bought the stock or authorized the transfer.[4] The reason for this conclusion has been already suggested:[5] a party cannot be drawn into a contract which he has not made, by the mere fact that another party has seen fit to make a certain entry on his books which the former has not authorized, and with which he is not in any way connected. The criterion of his liability is said to be whether any act has been done by which the corporation was forced to receive him as a stockholder.[6] But this is believed to be unsound, though the case may have been correctly decided. The corporation may *waive* formalities which it might have insisted on, and admit the transferee to his rights as a proprietor, and if it does this, it is not perceived why he should not stand in that relation toward its creditors.[7]

§ 3303. What will not be Evidence of such Consent. — But where a *fraud* has been practiced on the transferee, the mere reception of *dividends* without knowledge of the fraud will not, of course, estop him from rejecting the transfer, unless he suffered an undue length of time to elapse, within principles already stated.[8] Thus, where a person subscribed for *new shares* in a national bank which had obtained author-

[1] Wilber *v.* Glen Iron Works, 18 Nat. Bank. Reg. 178; Robinson *v.* Lane, 19 Ga. 237; Simmons *v.* Hill, 96 Mo. 679; *s. c.* 2 L. R. A. 476; 10 S. W. Rep. 61.

[2] Keyser *v.* Hitz, 133 U. S. 138.

[3] Robinson *v.* Lane, 19 Ga. 337.

[4] Tripp *v.* Appleman, 33 Fed. Rep. 19.

[5] *Ante*, § 1919.

[6] Stephens *v.* Follett, 43 Fed. Rep. 842; *s. c.* 31 Am. & Eng. Corp. Cas. 466.

[7] See Laing *v.* Burley, 101 Ill. 591. And compare Chemical Nat. Bank *v.* Colwell, 132 N. Y. 250; *ante*, § 2388.

[8] *Ante*, § 1488, *et seq.*

ity to *increase* its capital stock, and, instead of issuing a certificate of the new shares to him, the officers of the bank issued a certificate of *old shares*, which the president had surrendered to the bank for that purpose,—the bank being in failing circumstances,—and led him to believe that the certificate represented the new shares for which he had subscribed, and he afterwards drew a dividend thereon, not knowing the fraud which had been practiced upon him, it was held that he was not liable as a shareholder, the bank having subsequently failed.[1] But this decision ignores the principle already discussed,[2] that where the shareholder has been induced to become such by fraud, he is under the duty of making inquiries and retreating from his position while the corporation continues to be a going concern, and cannot do so, as against its creditors, after winding-up proceedings have commenced. The unauthorized act of one's agent in causing shares purchased for him to be registered on the books of the corporation in his name will not, it has been held, make him shareholder in a proceeding on behalf of creditors after insolvency, — as where a broker, employed to purchase shares for a customer, which he was to hold for him on a margin, employed another broker to effect the purchase, and the latter, having purchased the shares, caused them to be transferred on the books of the company into the name of the former. Here the shares were transferred to him without his authority, and by the mere mistake of his agent, he merely having purchased them for his customer. He never intended to hold them as owner, but merely to hold them as a pledgee as a security for his advances, and did not intend to assume toward the corporation or its creditors the position of shareholder. The corporation having failed, it was held that he was not liable as a shareholder.[3] Nor did the fact that the governing statute[4] provided that "where stock is assigned by its owner, and the assignee's name does not appear on the books of the company, the title

[1] Stephens *v.* Follett, 43 Fed. Rep. 842; 31 Am. & Eng. Corp. Cas. 466.

[2] *Ante*, § 1440.

[3] Glenn *v.* Garth, 133 N. Y. 18; *s. c.* 44 N. Y. St. Rep. 80; 30 N. E. Rep. 649; affirming *s. c.* 39 N. Y. St. Rep. 473; *s. c.* 15 N. Y. Supp. 202.

[4] Code Va. 1860, ch. 57, § 27.

to the stock is vested in the assignee, so far as may be necessary to effect the purpose of the sale, pledge, or other disposition," and that "a person in whose name shares of stock stand on the books of the company shall be deemed the owner thereof, as regards the company,"[1] make the purchaser of shares liable to creditors under the facts above set out. The meaning of these provisions is, that a corporation which has acknowledged the title of a person to its shares cannot dispute it, and not that the mere fact that some one has entered the name of a stranger on the books of the corporation as a shareholder shall be conclusive against him for the purpose of charging him in favor of its creditors.[2]

§ 3304. Error in Distinguishing the Numbers of the Shares not Material. — But an error in distinguishing the numbers of shares is not material, provided the transferor has that number of shares. Accordingly, when fifty shares, bearing particular numbers, were transferred by the chairman of a company to A., as trustee for the company, and A.'s name was placed on the register in respect of those shares, and it appeared that the transferor had at the time no shares bearing those numbers, though he had fifty shares bearing other numbers, it was held that A. must go on the list of contributories for fifty shares. The numbers of shares were merely a directory, for the purpose of tracing title to the shares, into which creditors were not expected to look. It was sufficient that they found his name on the register in respect of fifty shares.[3]

§ 3305. Not Necessary that New Certificates should have Issued to the Transferee. — We have already seen that the usual and formal way of transferring shares on the books of a corporation to a purchaser from a previous holder involves the taking up of the old certificate by the secretary, or other officers

[1] Code Va. 1860, ch. 57, § 25.

[2] Glenn *v.* Garth, *supra*. See, also, the peculiar facts of Bunn's case, 2 De Gex, F. & J. 275, set out at length in 2 Thomp. Stockh., § 203, p. 239.

[3] Ind's case, L. R. 7 Ch. 485. Compare Sewell's case, L. R. 3 Ch. 131; Feiling's case, L. R. 2 Ch, 714; and especially Stephens *v.* Follett, 43 Fed. Rep. 842.

of the company, and the issuing in its stead of a new certificate to the transferee.[1] We have also had occasion to consider numerous holdings to the effect that the possession of a share certificate is not necessary to constitute one a shareholder, even as between him and the company, — the certificate being merely an additional evidence of his title.[2] In view of these principles, it has been held that the record of transfers of shares on the books of a national bank is sufficient, as between the transferee and the bank, to work a change of ownership, so as to make the transferee liable to creditors in the event of the insolvency of the bank, *without the issuing of new certificates* to the transferee.[3]

§ 3306. Transferee Liable without Reference to the Motive of the Transfer. — The corporation, or its representative, may, of course, *affirm* a transfer made by a shareholder to escape his liability. And if the transfer is in the nature of a fraudulent conveyance by the transferor, to hinder and delay his general creditors, the corporation or its representative may nevertheless affirm it, and assess the transferee as a shareholder, — even where she is the wife of the transferor.[4]

§ 3307. Retransfer in Pursuance of a Previous Agreement. — It has been held that a retransfer of shares in a manufacturing company by B. to A., in pursuance of an agreement to do so, made contemporaneous with the original transfer by A. to B., terminates B.'s statutory liability as a stockholder for the debts of the company, although made for that purpose, where the original transfer was merely as collateral security for a debt.[5]

§ 3308. Vendor in Unregistered Transfer may Recover Over against Vendee. — Where the vendor in an unregistered transfer of shares, not being himself in fault, has been obliged to pay debts of the corporation in consequence of the *failure*

[1] *Ante*, § 2377.

[2] *Ante*, § 1140.

[3] Keyser *v.* Hitz, 133 U. S. 138; *ante*, § 2378.

[4] Keyser *v.* Hitz, 133 U. S. 138.

[5] Holyoke Bank *v.* Burnham, 11 Cush. (Mass.) 183.

of his vendee to register the transfer, he may recover from his vendee the amount so paid, in an appropriate action;[1] since "the very essence of a contract of sale and purchase in the case of shares is, that one party shall divest himself of, and the other acquire, in the name of himself, the ownership of the shares, and that the seller shall relinquish and be relieved from, and the purchaser assume, all future benefits and liabilities in respect of the shares."[2] Where there is a *statutory liability,* which attaches to the original stockholder, and is not discharged by a subsequent transfer of his shares, the successive assignees or holders, by accepting the stock and the benefits arising therefrom, impliedly undertake to indemnify or discharge him from the liability which attached to him as stockholder while he held the stock;[3] but it has been held that he cannot maintain an action for indemnity in respect of a call, against his immediate vendee, in a case where the latter had transferred the shares *before* the time when the call was made:[4] his right of action is against the assignee, who was the holder *at the time* when the call was made. It has been held that this right of indemnity does not exist, unless the vendor of the shares shows a *compulsory payment,* and that, to

[1] Hutzler *v.* Lord, 64 Md. 534; Johnson *v.* Underhill, 52 N. Y. 203; Castellan *v.* Hobson, L. R. 10 Eq. 47; Walker *v.* Bartlett, 36 Eng. L. & Eq. 368; *s. c.* 18 Com. B. 845; Wynne *v.* Price, 3 De Gex & S. 310; overruling, in part, Humble *v.* Langston, 7 Mees. & W. 517, and following Burnett *v.* Lynch, 5 Barn. & C. 589, where an assignment had been made by deed-poll, subject to the covenants in a lease, and it was held that the lessee might maintain an action on the case against the assignee for having neglected to perform the covenants named in the lease, whereby he had sustained damage. Compare Sayles *v.* Blane, 14 Ad. & El. (N. S.) 205; Shaw *v.* Fisher, 2 De Gex & S. 11; Brigham *v.* Mead, 10 Allen (Mass.), 245; Shaw *v.* Rowley, 16 Mees. & W. 810.

[2] Grissell *v.* Bristowe, L. R. 3 C. P. 112, *per* Bovill, C. J.

[3] Brown *v.* Hitchcock, 36 Ohio St. 667; Thebus *v.* Smiley, 110 Ill. 316.

[4] The Virginia Code (ch. 57, § 26) provides that stock shall not be assigned until assessments shall have been paid, and that the assignor and assignee shall each be liable for any installments which may have accrued, or which may thereafter accrue. A subscriber sold to A., who in turn sold to B. After the sale to B., a call was made on the stock. The original subscriber was compelled to pay. It was held that A. was not liable to him, A. having transferred the stock before the call was made. Brinckley *v.* Hambleton, 67 Md. 169.

this end, he must make it appear in what manner he was compelled to pay.[1]

§ 3309. Liability to Pay Assessments as between Vendor and Purchaser.— This, of course, may depend upon the *contract* which the buyer and seller make between themselves. It has been held that one who sells shares of the capital stock of a corporation before the issue of certificates, agreeing to give the buyer a certificate when he gets it, is not bound, as between the buyer and himself, to pay an assessment laid upon the shares subsequently to the sale, and before the issue of certificates.[2]

§ 3310. Transfer, how Proved to Make Transferee Liable. Where there is a statute requiring a *public register* of transfers, the formal transfer of shares necessary to make the transferee liable for corporate debts is shown, *prima facie*, by the stock *certificate*, or by the *copy of the list* of shareholders filed, under the statute, with the *register of deeds*.[3]

§ 3311. Point of Time at Which Liability Attaches to Transferee.—Another important inquiry is, at what point of time a liability to creditors attaches to the transferee of shares, where the transfer is not perfected on the books of the corporation prior to the intervention of the circumstances which fix the liability. The answer to this inquiry would seem to be, on principle, that the liability accrues at the time when the transferee becomes the *real owner*, and that if he chooses to *conceal his ownership*, by keeping his name off the books, that ought not to exonerate him.[4] The question is, however, more or less influenced by statutes. For instance, the statute of New York, known as the Manufacturing Act,[5] provides that the stockholders of every company incorporated under that act shall

[1] Hutzler *v.* Lord, 64 Md. 534. Evidence to go to the jury of a contract to indemnify the transferor against future installments: Trevor *v.* Perkins, 5 Whart. (Pa.) 244.

[2] Brigham *v.* Mead, 10 Allen (Mass.), 245.

[3] Cleveland *v.* Burnham, 64 Wis. 347.

[4] *Ante*, § 3295.

[5] New York Laws 1848, ch. 40, § 10.

be individually liable for the debts of the corporation created before the capital stock has been fully paid in. Another section provides that each corporation shall keep a book containing the names of the stockholders and their places of residence, the number of shares each owns, and the time when he became the owner; and that, until a transfer of stock is recorded on this book, it shall not be valid for any purpose whatever, "except to render the person to whom it shall be transferred liable for the debts of the company according to the provisions of this act." It has been held, in an action to enforce the individual liability prescribed by this statute, that a transferee of shares is liable *from the date when the shares are assigned to him*, provided the debt which is sought to be enforced accrued subsequently, although the shares were not transferred to him on the books of the company until after the debt had been created.[1]

§ **3312. Shares Transferable Free from Liability when It has been Exhausted.** — Where the governing statute creates the usual *superadded individual liability* to the amount of the par value of the shares, although they may have been fully paid up, this liability is a single liability, and attends the shares in such a sense that if it is discharged by a transferor of them prior to the transfer, the transferee of them will take them discharged of the liability.[2]

§ **3313. Purchasers at Execution Sale.** — Purchasers of shares at execution sale get, as a general rule, only such title as the execution debtor had at the time when the execution became a lien upon his shares, under the statute governing the liens of writs of *fieri facias* upon personal property.[3] When, therefore, the execution debtor had transferred his shares on the books of the corporation in absolute form, although intended merely as a pledge, to a third person, and

[1] Washburn &c. Man. Co. *v.* Clark, 43 N. Y. St. Rep. 709; *s. c.* 17 N. Y. Supp. 568.

[2] Thebus *v.* Smiley, 110 Ill. 316.

[3] See, generally, on this subject, *ante*, § 2765, *et seq.*

his creditor subsequently levied his execution upon them, caused them to be sold thereunder, and himself became the purchaser of them, it was held that he acquired no title by such purchase, so as to make him chargeable with liability as a stockholder to the creditors of the corporation.[1]

[1] Simmons *v.* Hill, 96 Mo. 679; *s. c.* 2 L. R. A. 476.

CHAPTER LVIII.

LIABILITY OF EXECUTORS, ADMINISTRATORS, HEIRS, AND LEGATEES.

SECTION
3317. Corporate shares pass not to the heir, but to the executor or administrator.
3318. The estate liable; not the executor or administrator.
3319. Doctrine in Massachusetts that estate not liable.
3320. The general American doctrine.
3321. Distinction between a statutory penalty and a liability arising out of contract.
3322. Charter extended and debts contracted after the death of stockholder.
3323. Whether executor or legatee a contributory.
3324. Right of executor to contribution against residuary legatee.
3325. Heirs assessable to the extent of assets received from ancestor.

SECTION
3326. Mode of enforcing contribution from estate of deceased shareholder.
3327. By a proceeding in equity.
3328. Suing executor without proceeding in probate court.
3329. Time within which demand against estate of deceased stockholder presented.
3330. When executor personally liable.
3331. Executor personally liable for breach of trust.
3332. Liability of the estates of deceased non-resident stockholders.
3333. Creditors not to be delayed until settlement of the estates of deceased shareholders.
3334. Executors *de son tort*.
3335. English doctrine on this subject considered.

§ 3317. Corporate Shares Pass not to the Heir, but to the Executor or Administrator.—"Although in some of the earlier American cases shares of corporations were treated as real estate,[1] and to obviate this rule express provisions were inserted, in railway and other charters, that the capital stock should be deemed and taken as personal estate,[2] it is now well

[1] I quote this language and the supporting authorities from one of the valuable notes of Judge Ashbel Green to the American edition of Brice's Ultra Vires, at page 140. See Tippets *v.* Walker, 4 Mass. 595; Howe *v.* Starkweather, 17 Mass. 240; Welles *v.* Cowles, 2 Conn. 567; Meason's Estate, 4 Watts, 341.

[2] Citing 1 Rev. Laws N. Y. 247; Laws N. J. 1830, p. 83, § 17.

established that the shares of all corporations are personal property."[1] Being *personal property*, they pass, on the death of the holder, not to his heir, but to his personal representative.

§ 3318. The Estate Liable, not the Executor or Administrator. — Executors or administrators of deceased stockholders are liable as contributories, not on the same principle as other trustees, but, in general,[2] only in respect of their trust estate.[3]

§ 3319. Doctrine in Massachusetts that Estate not Liable. Two or three early Massachusetts cases holding the contrary, under a statute of that State,[4] are thought to be not of authority on this question. The statute gave to creditors in a certain case an execution against the body and goods of the stockholders. This was held not to give an execution against the estate of a stockholder who had died before the commencement of the action against the corporation; for the statute was construed to apply to those only who were members of the corporation at the time of the commencement of the action.[5] Subsequently, the court went to the length of holding that the statute did not make the debts of the corporation a charge upon the estate of a deceased shareholder; and, therefore, if the administrator paid money as his intestate's contributory share of the debts of the corporation, he was not allowed to charge it in his administration account. But it was conceded that if the shares were valu-

[1] Citing Waltham Bank *v.* Waltham, 10 Met. (Mass.) 334; Hutchins *v.* State Bank, 12 Met. (Mass.) 421; Wheelock *v.* Moulton, 15 Vt. 519; Isham *v.* Bennington Iron Co., 19 Vt. 230; Arnold *v.* Ruggles, 1 R. I. 165; Denton *v.* Livingston, 9 Johns. 96; *s. c.* 6 Am. Dec. 264; Gilpin *v.* Howell, 5 Pa. St. 41; *s. c.* 45 Am. Dec. 720; Slaymaker *v.* Bank of Gettysburg, 10 Pa. St. 373; State *v.* Franklin Bank, 10 Ohio, 91; Johns *v.* Johns, 1 Ohio St. 350; Heart *v.* State Bank, 2 Dev. Eq. (N. C.) 111; Planters' & Merchants' Bank *v.* Leavens, 4 Ala. 753; Union Bank *v.* State, 9 Yerg. 490; Brightwell *v.* Mallory, 10 Yerg. 196. See *ante*, § 1066.

[2] Compare *post*, § 3330.

[3] Blakeley's Executor's case, 13 Beav. 133; affirmed on appeal, 3 Macn. & G. 726; Ex parte Gouthwaite, 3 Macn. & G. 187; Bulmer's case, 33 Beav. 435; Hamer's Executor's case, 3 De Gex & S. 279; Gouthwaite's case, 3 De Gex & S. 258; Taylor *v.* Taylor, L. R. 10 Eq. 477; Houldsworth *v.* Evans, L. R. 3 H. L. 263, 282. See, also, Robinson's Executor's case, 6 De Gex, M. & G. 572; Grew *v.* Breed, 10 Met. (Mass.) 569; New England Commercial Bank *v.* Newport Steam Factory, 6 R. I. 154, 189; *s. c.* 75 Am. Dec. 688.

[4] Mass. Stat. 1808, ch. 65.

[5] Child *v.* Coffin, 17 Mass. 64.

able property, and liable to assessment, it might be the duty of the administrator to pay the assessments, in order to save a forfeiture. There was no suggestion that if the company should become prosperous, the administrator would be precluded from drawing dividends in respect of his intestate's shares. This doctrine, opposed, it would seem, to the plainest notions of justice, was pronounced in an American court as late as the year 1830, and by a judge of deserved eminence.[1] Two years later the same court refused to sustain a suit for a contribution, by a shareholder who had paid debts of the corporation, against the executors of a deceased shareholder; but this was placed on a ground equally destitute of justice, namely, that shareholders are not liable to contribute to one of their number who has voluntarily paid the debts of the company, unless they have engaged in writing to do so, in which case the remedy is to be sought under the written agreement.[2] As late as 1860, the same court held that where a stockholder who has been summoned, pursuant to a statute,[3] for the purpose of charging him with a debt of the corporation, dies, the proceeding abates, and cannot be revived against his executor.[4] A justification of this ruling was sought in the language of Shaw, C. J., in a previous case, that the liability of a stockholder to pay the debts of the corporation was one "depending solely upon the provisions of positive law," and "to be strictly construed, and not to extend beyond the limits to which it is plainly carried by such provisions of statute."[5] But in a case determined in the same court in 1846, under a statute making stockholders of banks individually liable for the redemption of their respective proportions of its bills, it was held, — Shaw, C. J., giving the opinion, — without referring to the former cases, or stating any reason for not following them, that administrators of deceased shareholders were liable, as for other debts of their intestates, in their representative capacity.[6]

[1] Ripley *v.* Sampson, 10 Pick. (Mass.) 371, opinion by Shaw, C. J. See, also, Cutler *v.* Middlesex Factory Co., 14 Pick. (Mass.) 483.

[2] Andrews *v.* Callender, 13 Pick. (Mass.) 484.

[3] Mass. Stat. 1851, ch. 315.

[4] Dane *v.* Dane Man. Co., 14 Gray (Mass.) 488.

[5] Gray *v.* Coffin, 9 Cush. (Mass.) 192, 199.

[6] Grew *v.* Breed, 10 Met. (Mass.) 569, 576. See, also, Bangs *v.* Lincoln, 10 Gray (Mass.), 600; Bacon *v.* Pomeroy, 104 Mass. 577. Compare Noble *v.* Halliday, 1 N. Y. 330; Marcy *v.* Clark, 17 Mass. 330; Middletown Bank *v.* Magill, 5 Conn. 28, 57. In Richmond *v.* Irons, 121 U. S. 27, 55, the Supreme Court of the United States refuse to apply the Massachusetts doctrine to the National Banking Act.

§ 3320. The General American Doctrine. — It is apprehended that the foregoing English decisions, in so far as they rest on general principles, state the law as it obtains in this country: namely, that the estate of a deceased shareholder is liable for his contributory share of the losses of the company, the same as for any other of his debts, and that a court having equity powers will enforce this liability by appropriate methods,[1] unless the statutory system of probate in the particular State excludes the jurisdiction of equity. This is analogous to the settled rule that the creditor of a partnership firm may pursue the estate of one of the deceased copartners for the satisfaction of his debt.[2] The general American doctrine is, that the liability of a shareholder, whether merely to pay what is unpaid in respect of his shares,[3] or to respond to a superadded liability imposed by statute,[4] or to answer in common with the other stockholders for the debts of the corporation, under the joint and several liability of partners,[5] does not die with him, but survives in respect of his estate in the hands of his executor or administrator. It is so held in respect of the individual liability of shareholders under the National Banking Act;[6] and also under the New York statute[7] relating to insurance companies, making "the trustees and corporators of any company organized under this act, and those entitled to a participation of the profits, ... jointly and severally liable until the whole amount of the capital raised by the company shall have been paid in, and a certificate thereof recorded, as hereinbefore provided."[8]

[1] New England Commercial Bank *v.* Newport Steam Factory, 6 R. I. 154, 189; *s. c.* 75 Am. Dec. 688; Grew *v.* Breed, 10 Met. (Mass.) 569, 576. This was assumed in Davidson *v.* Rankin, 34 Cal. 503.

[2] Devaynes *v.* Noble, 1 Mer. 528; *s. c.* 2 Russ. & M. 495.

[3] Manville *v.* Edgar, 8 Mo. App. 324; Davidson *v.* Rankin, 34 Cal. 503; Bailey *v.* Hollister, 26 N. Y. 112. See Robinson's Executor's case, 6 De Gex, M. & G. 572; Blakeley's Executor's case, 3 Macn. & G. 734.

[4] *Ante*, § 3026.

[5] Chase *v.* Lord, 77 N. Y. 1.

[6] Richmond *v.* Irons, 121 U. S. 27.

[7] N. Y. Act of 1849, ch. 308, § 19.

[8] Chase *v.* Lord, 77 N. Y. 1; *s. c.* 6 Abb. N. C. (N. Y.) 258; reversing *s. c.* 16 Hun (N. Y.), 369. The decision was by a *divided court, four* judges concurring and *three* dissenting. Other cases, reaching the same conclusion

§ 3321. Distinction between a Statutory Penalty and a Liability Arising out of Contract. — In all these cases the courts proceed on a distinction between a statutory *penalty* and a liability arising out of *contract*, conceding that the former does not survive, but holding that the latter does. Even where the liability is larger than that imposed by the common law, amounting to the obligation of a partner, the courts say that it is not in the nature of a penalty or forfeiture, and does not exist solely as a liability imposed by statute; but it is a liability *voluntarily assumed* by the act of becoming a stockholder.[1] In speaking upon this question, with reference to the National Banking Act, it was said by Mr. Justice Matthews: "Under that act the individual liability of the stockholders is an essential element in the contract by which the stockholders became members of the corporation. It is voluntarily entered into by subscribing for and accepting shares of stock. Its obligation becomes a part of every contract, debt, and engagement of the bank itself, as much so as if they were made directly by the stockholder, instead of by the corporation. There is nothing in the statute to indicate that the obligation arising upon these undertakings and promises should not have the same force and effect, and be as binding in all respects, as any other contracts of the individual stockholder. We hold, therefore, that the obligation of the stockholder survives as against his personal representatives."[2]

§ 3322. Charter Extended and Debts Contracted after the Death of Stockholder. — Moreover, if the charter of the cor-

as to individual liability under statutes more or less similar to the above are: Diven *v.* Duncan, 41 Barb. (N. Y.) 520; Cochran *v.* Weichers, 119 N. Y. 399; *s. c.* 7 L. R. A. 553; 29 N. Y. St. Rep. 388; 23 N. E. Rep. 803; affirming *s. c.* 25 N. Y. St. Rep. 571; 6 N. Y. Supp. 304. Where a stockholder of such bank was living and a resident of the county at the time when the notice to stockholders began to be published there, his death soon after did not abate the proceeding, or render the publication ineffectual. Diven *v.* Duncan, 41 Barb. (N. Y.) 520.

[1] Lowry *v.* Inman, 46 N. Y. 129, *per* Allen, J. See, also, Wiles *v.* Suydam, 64 N. Y. 173; Flash *v.* Conn, 109 U. S. 371; Hobart *v.* Johnson, 19 Blatchf. (U. S.) 359; reasoning of Gould, J., in Bailey *v.* Hollister, 26 N. Y. 112, 116.

[2] Richmond *v.* Irons, 121 U. S. 27, 55, 56.

poration contains a clause, by which the Legislature reserves to itself the power to alter or repeal it, the stockholder holds his stock subject to such liability as may attach to him in consequence of an extension or renewal of the charter, whether with or without his consent. His administrator will, therefore, be liable to make good out of his estate any debts which the corporation may have contracted, although the *charter* may have been *extended* after his death, and although the debts may have been contracted after his death.[1]

§ 3323. Whether Executor or Legatee a Contributory. — Whether the executor or legatee is to be held to respond for the benefit of creditors depends upon the question whether the *legal title* to the shares passes to the *executor* or to the *legatee;* and this will depend in some cases upon the terms of the will, and this will in turn yield to the provisions of the statutes relating to the settlement of the estates of deceased persons. It may also depend upon the terms of the charter of the corporation. Under a provision in the charter of a corporation, that, on the death of a stockholder, his *heirs* or *legal representatives* might continue the relation, it was held that the right to continue the membership was in the *heirs* or *devisees,* and not in the personal representative.[2] The policy of many of the unlimited joint-stock companies of England has been to prohibit, in their deeds of settlement, the free alienation of their shares without the *consent of their directors.*[3] The reason of this restriction is obvious: if shares could be freely transferred, irresponsible proprietors might be introduced in the place of responsible ones, and, in the event of the company being wound up, the burden of paying its debts might be cast on a few of its members. With the same objects in view, the deeds of settlement of many of those companies made the admitting of executors, administrators, or legatees as proprietors to depend upon the approbation of the directors, and upon their executing the deed of settlement like other proprie-

[1] Bailey *v.* Hollister, 26 N. Y. 112.

[2] Montgomery Mut. Building &c. *v.* Robinson, 69 Ala. 413. Compare Security Loan Asso. *v.* Lake, 69 Ala. 456.

[3] *Ante*, § 3242.

tors. Now, it has been ruled by the courts of that country that, whilst a clause in the deed of settlement of a joint-stock company, however precise, may be *waived* by all its members, yet it cannot be waived by its directors, unless it is shown that the members have made the directors their agents for that purpose.[1] When, therefore, under such a deed of settlement, a shareholder bequeathed his shares, and the executor assented to the bequest, and the secretary placed the name of the legatee and her husband opposite the shares in the books of the company, but the provisions of the deed of settlement had not been complied with as to the transfer of the shares, nor was it shown that all the shareholders of the company had concurred in dispensing with such compliance, the executor was held to be the proper person to be placed on the list of contributories.[2]

§ 3324. Right of Executor to Contribution against Residuary Legatee.—Suppose the executor of a deceased shareholder turns the shares over to a residuary legatee, and afterwards calls are made for unpaid balances due in respect of them, which the executor is compelled to pay, can he recover the amount so paid from the residuary legatee or (what is the same thing) from his assignee? The rule which determines the answer to this question is said to be that if the executor distributes the funds of the estate in his hands to the residuary legatees, with notice of *debts* due or to become due from the estate, he will make the distribution in his own wrong, in such a sense that he cannot recover from the legatees what he may subsequently be compelled to pay in respect of such debts. But there is a limitation to this rule, which distinguishes between debts and mere contingent liabilities which may or may not ripen into debts. Such was the principle upon which Sir George Jessel, Master of the Rolls, proceeded in a case, where he thus stated his conclusion: "I have looked through many cases, and I have asked for the assistance of the bar, and I cannot find the rule stated in wider terms than these:

[1] Keene's Executor's case, 3 De Gex, M. & G. 272.

[2] *Ibid.*

that he cannot recover from a legatee a payment made with notice of a debt."[1] Proceeding upon this principle, and approving this statement of it, the English Court of Appeal have held that where an executor had turned over certain shares belonging to the estate, to the assignee of a residuary legatee, together with sufficient money to make payment of the unpaid balance due the company in respect of them, which balance had not then been called for by the company, but the executor was nevertheless, in an action brought by the company upon a subsequent call, compelled to discharge it out of his own funds, — he could maintain an action in equity against the assignee of the residuary legatee for the reimbursement of the moneys so expended.[2]

§ 3325. Heirs Assessable to the Extent of Assets Received from Ancestors.—Where the estate of the deceased shareholder is fully administered, and distribution made by the personal representative, the heirs or next of kin are assessable, to the extent of the assets which they have received from the ancestor's estate, for the payment of calls subsequently made upon shares of stock belonging to his estate.[3]

§ 3326. Mode of Enforcing Contribution from Estate of Deceased Shareholder. — The manner of enforcing contribution from the estate of a deceased shareholder, for the benefit of the creditors of an insolvent corporation, is a question which, to a great extent, refers itself to the peculiar practice of each State. Under many American statutory systems relating to the administration of the estates of decedents, the proper way would be to *prove the demand against the estate* in the probate court, after presenting it to the executor or administrator for allowance, or giving him the statutory notice.[4]

[1] Jervis *v.* Wolferstan, L. R. 18 Eq. 18.

[2] Whittaker *v.* Kershaw, 45 Ch. Div. 320.

[3] Payson *v.* Hadduck, 8 Biss. (U. S.) 300.

[4] Nolan *v.* Hazen, 44 Minn. 478; *s. c.* 47 N. W. Rep. 155. A claim in favor of the creditors of a corporation against the estate of a deceased stockholder, before the assets of the corporation are fully administered, is a "*contingent claim*" within the meaning of Minn. Gen. Stats., ch. 53, relat-

§ **3327. By a Proceeding in Equity.** — We have already referred to a holding in Massachusetts, seemingly out of line with the other holdings in that State, but quite in line with other American holdings and with sound principle, to the effect that the estate of a deceased stockholder of a bank may be pursued in equity to subject his individual statutory liability to contribute ratably for the redemption of its bills.[1] In Rhode Island, it has been held that a statutory liability of a stockholder for the corporate debts, upon the death of the stockholder, did not, at law, survive against his estate, and that no action at law could be maintained against the personal representative of such stockholder to enforce the same; but that the estate of a deceased stockholder might be pursued by the creditor in *equity*, which, for the sake of the remedy, and to correct the form of the contract so as to carry out its substance, would construe it to be several as well as joint; that in such case a court of equity would decree in favor of the creditor of the corporation an account of the personal estate of a deceased stockholder, and payment of his debt out of the surplus of the same, after the payment of the separate debts of such stockholder and of the expenses of settling his estate, without regard to the solvency or insolvency of the stockholders liable, and without reference to the state of accounts between the stockholders and the corporation, leaving the estate to seek repayment from the corporation, or contribution from those liable to it. It was also held that, to a bill seeking relief from the estate of a deceased stockholder, all the living stockholders and representatives of deceased stockholders liable to the debt must, as interested in the account to be taken, be made parties defendant to the bill; that, if the real assets of the deceased stockholder are sought to be charged, his heirs at law, in case of intestacy, and his devisees, if there be a will, must also be made parties defendant to the bill; that, as two or more creditors for whose claims

ing to claims against decedent estates. Hospes *v.* Northwestern Man. &c. Co., 48 Minn. 174; *s. c.* 31 Am. St. Rep. 637; 15 L. R. A. 470; 45 Alb. L. J. 277; 36 Am. & Eng. Corp. Cas. 206; 50 N. W. Rep. 1117.

[1] Grew *v.* Breed, 10 Met. (Mass.) 569, 576; *ante*, § 3319.

different sets of stockholders are liable cannot unite them all in the same bill for the purpose of separate relief against those respectively liable to them, so the same creditor cannot enforce in the same bill, against the estates of deceased stockholders, different debts, for which all the estates pursued are not liable; but that there is no objection; on the ground of *multifariousness*, to a creditor's seeking, in the same bill, relief out of the estates of two or more deceased stockholders, all of which are liable to his debt.[1] In an important English case, a company had been ordered to be wound up under the Companies Act, 1862, and the executor of a deceased shareholder had been made a contributory. The official liquidator filed a bill, on behalf of himself and all other creditors of the testator, against the executor and the devisees, for the administration of the testator's estate, and to enforce the calls against the real estate. It was held by Lord Romilly, M. R., that the suit was properly instituted, and that, notwithstanding a *lapse of nine years* from the death of the testator to the winding up of the company, the real estate in the hands of the devisees was liable to the payment of calls. The *statute of limitations* had nothing to do with the case, for the debt did not arise until the call was made by the official liquidator.[2] It was true that the debt did not exist when the testator died; but in that respect the case did not differ from the cases where a testator has in his lifetime become surety for the due performance of a covenant, which is broken many years after his death, or where executors[3] of a deceased person are chargeable, long after his death, with the loss occasioned by a breach of trust committed by him.[4]

§ 3328. Suing Executor without Proceeding in Probate Court. — The various statutory schemes of administration in force in American jurisdictions provide that unless claims

[1] New England Commercial Bank *v.* Newport Steam Factory, 6 R. I. 154; *s. c.* 75 Am. Dec. 688.

[2] *Post*, § 3779, *et seq.*

[3] As in Knatchbull *v.* Fearnhead 3 Mylne & C. 122.

[4] Turquand *v.* Kirby, L. R. 4 Eq. 123. Compare Baird's case, L. R. 5 Ch. 736, where this case is noticed.

against the estate of the decedent are presented to the executor or administrator for allowance within a stated time, they shall be forever barred. Construing such a statute,[1] it has been held that it has no application to the case where a judgment creditor of an insolvent corporation brings a suit in equity against the corporation, and against personal representatives of its deceased shareholders, to subject what was due from the shareholders to the satisfaction of his judgment against the corporation. The reasoning on which this conclusion was based was, that such an action is not an ordinary action to recover a money demand, but is an action to appropriate to the uses of a trust a portion of a trust fund held by the decedent, which, in theory of law, never became a part of his estate, or passed to his personal representatives.[2] It is believed that this conclusion cannot be upheld upon principle. The rule which allows a trust fund to be followed from hand to hand, and recovered, is believed to apply only in cases where the fund is ear-marked or separated from the remainder of the estate of the trustee in such a manner that it can be identified.[3]

§ 3329. Time within Which Demand against Estate of Deceased Stockholder Presented. — Under the Missouri statute, relating to the administration of estates, if a demand is not due, the court has power to adjust the same and to render judgment for the amount, or, at the option of the parties, to make a rebate of interest therefrom at the rate of six per cent per annum until due. If the parties do not agree to a rebate of interest, then no execution is to issue upon the judgment until the demand becomes due. It is the settled construction of this statute that the *special statute of limitation* relating to the administration of estates, under which claims against the estate of a decedent must be exhibited to the administrator within two years from the granting of letters, or be forever barred, begins to run from the time when a substantial right

[1] Comp. Laws Nev., §§611, 618.

[2] Thompson *v.* Reno Sav. Bank, 19 Nev. 242; *s. c.* 3 Am. St. Rep. 883; citing Gunter *v.* Janes, 9 Cal. 643.

[3] *Post*, ch. 167.

of recovery upon the demand accrues.[1] Thus, in the case of merely inchoate or contingent demands, such as a dormant warranty, the statute does not begin to run until the period has arrived at which a cause of action would have accrued against the decedent had he continued to live.[2] But in the case of a fixed demand which matures at a future date certain, the holder must exhibit it to the administrator within two years of the grant of the letters, although it may not be due.[3] In a case where, in consequence of the insolvency of a corporation, a right accrues to its creditors, under a statute, to proceed against its shareholders, to subject to the payment of their demands against the corporation any balance which remains due and unpaid of the subscription of the shareholder to the corporation, in respect of his shares, the special statute of limitations *begins to run from the date of the insolvency of the corporation*, which is tantamount to a *dissolution*[4] — assuming that it is a case where the shareholder is dead, and letters testamentary or of administration have been granted upon his estate. Although in such a case the demand of the creditor may consist of debentures of the corporation which have not yet matured, he must exhibit them to the administrator for allowance within two years after the insolvency of the corporation, or his claim will be barred.[5] It follows from this that, if a corporation becomes insolvent pending an administration of the estate of one of its deceased shareholders, whose stock is not fully paid in, and no call has ever been made by the corporation against the stockholder, or his executor or administrator, a creditor of the corporation cannot, after the final settlement and distribution of the estate of the deceased shareholder, maintain an action against the executor or administrator of such decedent, upon a demand due to him from the corporation, although the executor or administrator is the

[1] Burton *v.* Rutherford, 49 Mo. 255, 258; Greenabaum *v.* Elliott, 60 Mo. 25, 32; Chambers *v.* Smith, 23 Mo. 174.

[2] Chambers *v.* Smith, 23 Mo. 174; Miller *v.* Woodward, 8 Mo. 169.

[3] Hicks *v.* Jamison, 10 Mo. App. 35.

[4] *Ante*, § 2009.

[5] Garesche *v.* Lewis, 15 Mo. App. 565, 570; *s. c.* affirmed, 93 Mo. 197.

devisee or legatee of the deceased shareholder.[1] If the indebtedness of the corporation consists of *coupons* which have not matured, then, under the foregoing principles, the coupons must be exhibited by the holder to the executor or administrator of the stockholder for allowance, within two years after the granting of letters, or the demand will be barred.[2]

§ **3330. When Executor Personally Liable.**—By the National Banking Act, "*persons* holding stock as executors, administrators, guardians, or trustees shall not be personally subject to any liabilities as stockholders; but the *estates* and *funds* in their hands shall be liable, in like manner and to the same extent as the testator, intestate, ward, or person interested in such trust funds would be if living and competent to act, and hold the stock in his own name."[3] Under this statute it has been held that an administrator is not personally liable to assessment on bank stock which always remained in his hands in his representative capacity, and was never transferred to him on the books of the bank, although he is *sole heir* to the intestate.[4] This is plain enough. But suppose the executor comes afterwards, and, by some act which he is not bound to perform in the exercise of his trust, makes himself a shareholder on the books of the company; then it may be assumed he puts himself in the place of any other trustee who voluntarily becomes a shareholder: he must respond out of his estate to the duties of the relation, and seek such indemnity as he can find elsewhere. Accordingly, if the executors of an estate invest any of the funds of the testator in shares, without any authority to do so in the will, the shares are to be treated as belonging to them, and not to the estate; and they, and not the estate, are responsible as stockholders.[5] "If it were otherwise, the executor of an insolvent estate might purchase any number of shares, and keep them if they were profitable, but repudiate any liability

[1] Larkin *v.* Willi, 12 Mo. App. 135, 138.

[2] Garesche *v.* Lewis, 15 Mo. App. 565, 572; *s. c.* affirmed, 93 Mo. 197.

[3] Rev. Stats. U. S., § 5152.

[4] Re Bingham, 32 N. Y. St. Rep. 782; *s. c.* 10 N. Y. Supp. 325.

[5] Diven *v.* Lee, 36 N. Y. 302; *s. c.* 34 How. Pr. (N. Y.) 197.

if they turned out otherwise, and thus involve the company in an account of the testator's estate. They have purchased these shares, whether with authority under the will or not is immaterial, and they have received dividends. They are, therefore, personally liable."[1] The rule in England seems, then, to be that if the executors come forward and voluntarily make themselves shareholders, they become personally liable as such, and must seek indemnity out of their trust estate;[2] and such an acceptance has been discovered in the act of the executor of participating in the profits,—that is to say, in receiving dividends.[3]

§ 3331. Executor Personally Liable for Breach of Trust. Outside of this principle, an executor may make himself personally liable to contribute for the benefit of creditors, by committing a breach of trust in improperly disposing of the *trust fund* in his hands, out of which contribution is regularly sought. Thus, it was held by Lord Romilly, M. R., that executors of a deceased shareholder, in a going and solvent company, commit a breach of trust in *paying a legacy* without providing for the liability attaching to the testator's estate at the time of his death, in respect of such shares; and that, in the event of the company afterwards being wound up, he must pay out of his own pocket the calls made upon him as a contributory.[4]

[1] Spence's case, 17 Beav. 203, *per* Lord Romilly, M. R. That an executor who carries on the business of his testator makes himself personally liable, see Ex parte Garland, 10 Ves. 119; Ex parte Richardson, 1 Buck, 209; Alsop *v.* Mather, 8 Conn. 584; *s. c.* 21 Am. Dec. 703; Stedman *v.* Feidler, 20 N. Y. 437; Thompson *v.* Brown, 4 Johns. Ch. (N. Y.) 619, 630; Wightman *v.* Townroe, 1 Maule & S. 412; Labouchere *v.* Tupper, 11 Moore P. C. C. 198; Liverpool Borough Bank *v.* Walker, De Gex & J. 24.

[2] Lind. Comp., 5th ed., 814; Dobson's case, L. R. 1 Ch. 231; Duff's Executors' case, 32 Ch. Div. 301; Jackson *v.* Turquand, L. R. 4 H. L. 305.

[3] Gouthwaite's case, 3 De Gex & S. 258. See, also, Hamer's Executor's case, 3 De Gex & S. 279. Compare Bulwer's case, 33 Beav. 435, where the acceptance of dividends was held not to bind an executrix under the circumstances. See, also, Pim's case, 3 De Gex & S. 11, where the acceptance was not held to bind the executor.

[4] Taylor *v.* Taylor, L. R. 10 Eq. 477. For another illustration of the principle on which this case was decided, see Knatchbull *v.* Fearnhead, 3 Mylne & C. 122.

§ 3332. Liability of the Estates of Deceased Non-resident Stockholders.—The principle which would operate to charge the property, existing within the jurisdiction, of a non-resident stockholder in a domestic insolvent corporation, in favor of its creditors, will, of course, operate to charge so much of his estate as may be in course of administration within the jurisdiction after his decease. It was so held in Michigan prior to the passage of a statute in 1877, which provided an exclusive remedy in proceedings to enforce the individual liability of the stockholders, which remedy included no provision for charging the estates of deceased stockholders. Nor did the fact that the statute was enacted before the commencement of the proceeding in the particular case make any difference, where the fact was that the deceased stockholder was a stockholder prior to the enacting of the statute, and was, under another statute, liable for the debts of the corporation contracted at that time, of which debts the complainant's was one.[1]

§ 3333. Creditors not to be Delayed until Settlement of the Estates of Deceased Shareholders. — It is quite obvious that, under no adequate remedial system will it be permitted that the creditors of an insolvent corporation are to be delayed in enforcing their demands against its shareholders, from the mere fact that some of them may have died, until the estates of such deceased shareholders can be *fully administered* by their respective executors or administrators. On this principle it has been seemingly well held by one of the appellate courts of Illinois that complainants in a suit in equity, to enforce the liability of stockholders, are not bound to wait for the settlement of given claims for contribution

[1] Grand Rapids Sav. Bank's Appeal, 52 Mich. 557. The statute in question is an instance of that foolish species of legislation which consists of an attempt to prescribe an *exclusive* remedy for the enforcement of a right, where a mere *casus omissus* on the part of the Legislature will operate to cut off all remedy in a given class of cases. It is better for legislators to prescribe remedies permissively, and to allow the courts to apply any remedies which the legislators may not happen to think of at the time when they legislated upon the subject.

between living stockholders and the estates or heirs of deceased stockholders, but that the adjustment of such controversies should be left to a suit or suits having that as the main and primary object in view.[1]

§ **3334. Executors de Son Tort.** — Possibly a person who, without letters, has assumed to administer upon the estate of a deceased shareholder may, under an application of the rules of law relating to executors *de son tort*, make himself a contributory without qualification.[2]

§ **3335. English Doctrine on this Subject Considered.** — In England, this question has often turned on the provisions of the *deed of settlement*, or other constating instrument of the company, and for that reason the decisions of those courts are not very safe guides in reaching just conclusions under American statutes and charters.[3] The controlling idea upon which the English courts have proceeded seems to be that the estate of the deceased shareholder is to continue liable until a new personal liability has been created pursuant to the deed of settlement, or other governing instrument.[4] The resulting doctrine has thus been formulated: In a joint-stock company the presumption is, that the executors of a deceased shareholder succeed to the full liability as well as to the rights of their testator. The deed of settlement is to be looked at, not to see whether it imposes such liability on the executors, but whether it takes away or limits it. The fact that by the deed of settlement executors are not entitled to the full privileges of shareholders, until they or their nominees have been registered as shareholders, is no proof of an intention to limit their

[1] Wood *v.* Wood, 40 Ill. App. 182.

[2] This was attempted in Ex parte Glaholme, 1 De Gex & S. 583 (affirmed, 1 Hall & T.) 121, but the case turned on the form of the master's summons, which fixed Glaholme as a contributory, as the representative of his deceased brother, upon whose shares he had received dividends without administering.

[3] See, for example, Ness *v.* Armstrong, 4 Ex. 21.

[4] Blakeley's case, 13 Beav. 133; affirmed on appeal, 3 Macn. & G. 726. The same point was ruled, under a similar deed of settlement, in Ex parte Gouthwaite, 3 Macn. & G. 187; in Baird's case, L. R. 5 Ch. 725; and in Turquand *v.* Kirby, L. R. 4 Eq. 123.

liability in their representative character.[1] The executor stands liable to contribute out of the estate in his hands, although he may not have had himself registered as the owner of the shares,[2] and his liability is not limited to debts incurred before the death of the testator, unless the deed of settlement imposes such a limitation.[3] In giving his opinion in one of a series of cases growing out of the lamentable failure of the City of Glasgow Bank, Lord Cairns, L. C., said: "An executor whose testator has held shares in a joint-stock company has generally one or two courses open to him. He may have the shares transferred into his own name, and become to all intents and purposes a partner in the company. He may, on the other hand, not wish to have the shares transferred into his name, and he ought, in that case, to have a reasonable time allowed him to sell the shares, and to produce a purchaser who will take a transfer of them."[4]

[1] Baird's case, L. R. 5 Ch. 725.

[2] Houldsworth *v.* Evans, L. R. 3 H. L. 263.

[3] Baird's case, L. R. 5 Ch. 725.

[4] Buchan's case (H. L.), 4 App. Cas. 549, 588.

CHAPTER LIX.

CONDITIONS PRECEDENT TO THE RIGHT TO PROCEED AGAINST STOCKHOLDERS.

ART. I. DISSOLUTION OF THE CORPORATION. §§ 3340–3348,
II. NECESSITY OF THE CREDITOR EXHAUSTING HIS REMEDY AT LAW. §§ 3351–3363.
III. WHAT WILL EXCUSE THIS NECESSITY. §§ 3367–3371.
IV. OTHER CONDITIONS PRECEDENT. §§ 3374–3388.

ARTICLE I. DISSOLUTION OF THE CORPORATION.

SECTION
3340. Scope of this chapter.
3341. Dissolution of the corporation does not extinguish its debts.
3342. Consequences of this principle.
3343. Effect of dissolution upon the liability of stockholders.
3344. Statutes making the liability of stockholders depend on a dissolution of the corporation.
SECTION
3345. What constitutes a dissolution of the corporation such as lets in remedies against the stockholders.
3346. Failing to elect officers, and sold out under execution.
3347. Becoming utterly bankrupt.
3348. How fact of dissolution pleaded.

§ **3340. Scope of this Chapter.** — Statutes exist in many States providing, in substance, that whenever any corporation shall become *dissolved, leaving debts unpaid*, its creditors shall have a right of action against its stockholders. These statutes involve an inquiry into the circumstances under which a corporation is to be deemed *dissolved* in such a sense as lets in the remedies of creditors. Outside of these statutes, and independently of their operation, whether the object of the creditor or creditors, or the receiver, assignee, official liquidator, or other representative of the creditors of the corporation, be to sequester for their benefit any sum or sums which may remain unpaid to the corporation in respect of their

shares, or to enforce against them a superadded statutory liability, under nearly all theories and systems, certain *conditions precedent* must have taken place before the proceeding against the stockholder can be instituted and prosecuted. Speaking in round terms, there is but one condition precedent, and that is that the remedies afforded to the creditor by the law, against the *legal assets* of the corporation, must have been exhausted. These legal remedies are usually exhausted in one of two ways: 1. By obtaining a judgment at law against the corporation, suing out an execution thereunder, and levying such execution upon all the property of the corporation which is subject to the same, without realizing enough to satisfy the judgment, and having it returned *nulla bona* as to the residue; or, failing to find any property whereon to levy it, having it returned *nulla bona* simply. 2. By the intervention of some circumstance which renders the recovery of a judgment, the suing out of an execution, etc., against the corporation nugatory. This circumstance usually consists of a *dissolution* of the corporation. This dissolution may be either a dissolution *in law* or a dissolution *in fact.* By a dissolution in law is meant a dissolution which may take place either (1) by a judgment of a court of competent jurisdiction; or (2) by a legislative repeal of the charter of the corporation, where the right of repeal has been reserved in the statute granting the charter, or in the constitution or general law; or (3) by the expiration of the period named in the charter as the period of the duration of the life of the corporation. By a *de facto* dissolution, we mean that dissolution which takes place, in substance and in fact, in the case of corporations organized for pecuniary gain, when the corporation, by reason of insolvency or for other reason, suspends all its operations and goes into liquidation. To these conditions precedent it may be possible to add others, resting on the terms of statutes in particular jurisdictions. These considerations suggest an outline of the discussion upon which it is now proposed to enter. It is first proposed to consider the circumstances under which a corporation is to be deemed dissolved, so as to let in the remedies of its creditors against its

stockholders under the operation of statutes such as those first spoken of, and generally in that connection the effect of the dissolution of a corporation upon the rights of its creditors. It is next proposed to consider under what circumstances the creditor of a corporation must exhaust his remedies against its assets before resorting to the liability of the stockholders, whether such liability be in respect of unpaid share subscriptions, or a superadded statutory liability; in which connection the chief inquiry will be whether the creditor must prosecute his demand to a judgment, execution, and return of *nulla bona*. It will be next in order to consider the circumstances which dispense with this last-named condition, which usually consist of a *de facto* dissolution of the corporation, such as under many systems will let in the remedies of creditors without the necessity of obtaining a judgment or having an execution returned *nulla bona*. A final inquiry will be into conditions precedent to the right of the creditor of the corporation to proceed against its stockholders, arising under various statutes and theories.

§ 3341. Dissolution of the Corporation does not Extinguish Its Debts. — A corporation, by the very terms and nature of its political existence, is subject to dissolution, either by a surrender of its corporate franchises, or by a forfeiture of them for willful misuser or non-user. Every creditor must be presumed to understand the nature and incidents of such a body politic, and to contract with reference to them. The existence of a private contract of a corporation cannot be invoked to fasten upon it a perpetuity of existence contrary to public policy and the nature and objects of its charter.[1] Nor can a judgment be rendered or revived against a dead corporation any more than against a dead person.[2] But the death of a natural person does not extinguish or impair his obligations to his creditors. On the contrary, his estate remains answerable for his debts as fully as though he were living. So the dissolution of a corporation does not extinguish

[1] Mumma *v.* Potomac Co., 8 Pet. (U. S.) 281, 287, *per* Story, J.

[2] *Ibid.;* Bonaffe *v.* Fowler, 7 Paige (N. Y.), 576.

its contracts with its creditors. Except as to such contracts as are, in the nature of the case, incapable of a specific performance, the obligation survives; and the creditors may still enforce their demands against any property belonging to the corporation which has not passed into the hands of a *bona fide* purchaser.[1] The old rule of the common law, that with the dissolution of a corporation both the debts due to it and from it are extinguished, is now thoroughly exploded.[2]

§ **3342. Consequences of this Principle.** — It follows that a legislative act dissolving a corporation and transferring its franchises to another is not unconstitutional, since it does not impair the obligation of its contracts.[3] So, it is a sound view that a man has no constitutional right not to pay his debts;[4] an act of the Legislature compelling him so to do does not impair the obligation of his contracts with his creditors, but gives validity to them; and hence, a statute providing that when a judgment is entered against an incorporated bank, ousting it of its franchises, its debtors shall not thereby be released from their debts and liabilities, and prescribing a mode for collecting such debts and enforcing such liabilities,

[1] Mumma *v.* Potomac Co., 8 Pet. (U. S.) 281, 286; Nevitt *v.* Bank of Port Gibson, 6 Smedes & M. (Miss.) 513, 558; Hightower *v.* Thornton, 8 Ga. 486; *s. c.* 52 Am. Dec. 412; Curran *v.* State, 15 How. (U. S.) 304, 311; Tarbell *v.* Page, 24 Ill. 46; Bacon *v.* Robertson, 18 How. (U. S.) 480; Tinkham *v.* Borst, 31 Barb. (N. Y.) 407.

[2] *Post*, § 3341; Nevitt *v.* Bank, 6 Smedes & M. (Miss.) 513, 520, opinion furnished by Ex-Chancellor Kent as counsel; quoted with approval in Hightower *v.* Thornton, 8 Ga. 486, 493; *s. c.* 52 Am. Dec. 412. The Supreme Court of Alabama held, in 1847, that a stockholder of a dissolved corporation was not liable to be garnished by a creditor. Paschall *v.* Whitsett, 11 Ala. 473. But see, to the contrary effect, Curry *v.* Woodward, 53 Ala. 371, 375. An isolated case is found in North Carolina, holding that when the debts of a corporation become extinguished by the dissolution of its charter, the individual liability of the shareholders becomes extinct also. Malloy *v.* Mallett, 6 Jones Eq. 345. A weak conception of the same kind crops out in Hopkins *v.* Whitesides, 1 Head (Tenn.), 31, and in Robison *v.* Beall, 26 Ga. 17. The decision in the last-named case is founded upon conceptions and surrounded by circumstances on a level with the manner in which the bank had been managed and wrecked.

[3] Mumma *v.* Potomac Co., 8 Pet. (U. S.) 281.

[4] Sparger *v.* Cumpton, 54 Ga. 355; Harris *v.* Glenn, 56 Ga. 94, 96.

is a valid exercise of legislative power.[1] A statute providing for a distribution among creditors of the property of corporations whose charters had become forfeited was likewise valid.[2] On the other hand, a law distributing the property of an insolvent trading or banking corporation among its stockholders, or giving it to strangers, or seizing it to the use of the State, would as clearly impair the obligation of its contracts as a law giving to the heirs the personal effects of a deceased natural person would impair the obligation of his contracts.[3] It follows that a corporation cannot, by dissolving itself, defeat the rights of its creditors; but if its officers die, resign, or refuse to act, and its shareholders neglect or refuse to appoint others in their place, a court of equity, which never allows a trust to fail for want of a trustee, will interfere, and appoint a receiver or manager *ad interim*, for the purpose of winding up and putting an end to the concern.[4]

§ **3343. Effect of Dissolution upon the Liability of Stockholders.** — In short, the interception of the creditor's remedy against the corporation, by its dissolution, does not suspend his remedy against the stockholders or affect their liability.[5] A dissolution of the corporation does not reduce the stockholders to the *status* of *partners* which they may have occupied before it was formed; nor does it render them personally liable for the corporate debts, except so far as the governing statute makes them so.[6] But under a statute giving to creditors of

[1] Nevitt *v.* Bank of Port Gibson, 6 Smedes & M. (Miss.) 513.

[2] Mudge *v.* Commissioners, 10 Rob. (La.) 460.

[3] Curran *v.* State, 15 How. (U. S.) 304, 312, *per* Curtis, J.

[4] Brown *v.* Union Ins. Co., 3 La. Ann. 177, 182; Curry *v.* Woodward, 53 Ala. 375. In Carlen *v.* Drury, 1 Ves. & B. 154, which involved the question of the neglect of the managers of the association of the Bankside Brewery to act, the Lord Chancellor said: "This court is not to be required on every occasion to take the management of every play-house and brew-house in the kingdom. But if the case justified the interference of the court, it may appoint a manager in the *interim*, for the purpose of winding up and putting an end to the concern. But there must be a positive necessity for the interference, arising from the refusal or neglect of the committee to act." See, also, Knowlton *v.* Ackley, 8 Cush. (Mass.) 93.

[5] Hyman *v.* Coleman, 82 Cal. 650; *s. c.* 23 Pac. Rep. 62; 16 Am. St. Rep. 178.

[6] Tarbell *v.* Page, 24 Ill. 46.

an insolvent corporation direct remedies against its stockholders, it is said that the liability of the stockholder to the corporation, in respect of what is unpaid on its shares, becomes *fixed* by the insolvency and dissolution of the corporation, and then becomes a *primary liability*.[1] Moreover, as we shall elsewhere see,[2] a *de facto dissolution* of the corporation, such as here described, excuses the creditor from the vain proceeding of reducing his claim to *judgment* against the corporation before the proceeding to enforce against the stockholders those remedies which the statute, on the general principles of law, gives him.[3]

§ 3344. Statutes Making the Liability of Stockholders Depend on a Dissolution of the Corporation. — Statutes exist in many jurisdictions, which, in various forms of expression, impose a liability upon stockholders to pay such debts of the corporation as may exist at the time of its dissolution. These acts have been the subject of frequent judicial construction, as will be seen in various portions of this chapter. An examination of them will show that they generally predicate the right to proceed against the stockholders upon the fact that the corporation *becomes dissolved leaving debts unpaid*. The operation of such a statute[4] is such that a dissolution of the corporation opens the door to an action by any creditor of the corporation against any of its stockholders, without first exhausting his remedies against the corporation by a judgment, execution, and return of *nulla bona*.[5]

§ 3345. What Constitutes a Dissolution of the Corporation such as Lets in Remedies against the Stockholders. — Let us next consider what constitutes such a dissolution of a

[1] Garesche *v.* Lewis, 93 Mo. 197.

[2] *Post*, § 3367, *et seq.*

[3] Shellington *v.* Howland, 53 N. Y. 371; affirming *s. c.* 67 Barb. (N. Y.) 14; with which compare Kincaid *v.* Dwinelle, 59 N. Y. 551; affirming *s. c.* 37 N. Y. Super 326.

[4] Here, Fla. Laws, 1868, ch. 1639, § 27.

[5] Gibbs *v.* Davis, 27 Fla. 531; *s. c.* 8 South. Rep. 633. So under a similar statute of Alabama: McDonnell *v.* Alabama Gold &c. Ins. Co., 85 Ala. 401; *s. c.* 5 South. Rep. 120.

corporation as lets in statutory remedies against its shareholders. And here it is to be first observed that it is not at all necessary that the forfeiture and dissolution should have been declared by the *judgment* of a court of competent jurisdiction.[1] Such a dissolution may, indeed, take place under a statute when its charter expires by operation of law, and when an injunction restraining it from doing business has been made perpetual.[2] But an adjudication of bankruptcy,[3] or a cessation of business by reason of utter insolvency, will equally have this effect.[4] Statutes exist in some of the States providing that for all debts of certain corporations, due and owing *at the time of their dissolution*, the persons then composing such companies shall be liable, to the extent of their respective shares of stock, and no further.[5] With such a statute in force, an insolvent corporation would cease to exercise its franchises and fade out of existence, and when creditors would proceed against the stockholders to enforce their individual liability, the latter would plead that the corporation was not dissolved, because there had been no direct proceeding to forfeit its franchises, resulting in a judgment of dissolution. The courts have met this by holding that if a corporation suffer *acts* to be done *which destroy the end and object for which it was created*, this is a dissolution within the meaning of the statute.[6] On the other hand, the rule seems to be well established that a mere neglect to comply with the requisitions of the charter or by-laws in regard

[1] McDonnell *v.* Alabama Gold Life Ins. Co., 85 Ala. 401; *s. c.* 5 South. Rep. 120; Shickle *v.* Watts, 94 Mo. 410, 420.

[2] Dane *v.* Young, 61 Me. 160.

[3] State &c. Asso. *v.* Kellogg, 52 Mo. 583; Tibballs *v.* Libby, 87 Ill. 142; *post*, § 3347.

[4] Penniman *v.* Briggs, 1 Hopk. Ch. (N. Y.) 300.

[5] Rev. Laws N. Y. 247; 1 Wag. Stat. Mo. 293, § 22; Code Ala. 1867, § 1760; McClel. Fla. Dig. 232; Laws Fla. 1868, ch. 1639, § 27. See Van Hook *v.* Whitlock, 3 Paige, 409.

[6] Slee *v.* Bloom, 19 Johns. (N. Y.) 456; *s. c.* 10 Am. Dec. 273; Briggs *v.* Penniman, 8 Cow. (N. Y.) 387; *s. c.* 18 Am. Dec. 454; affirming Penniman *v.* Briggs, 1 Hopk. Ch. (N. Y.) 300; State Sav. Asso. *v.* Kellogg, 52 Mo. 583; Dryden *v.* Kellogg, 2 Mo. App. 87; Perry *v.* Turner, 55 Mo. 418, 427; Gibbs *v.* Davis, 27 Fla. 531; *s. c.* 8 South. Rep. 633; Chesapeake &c. Co. *v.* Griest, 85 Ky. 619; *s. c.* 4 S. W. Rep. 323.

to the time of electing officers does not work a forfeiture of corporate rights and privileges.[1] Within the meaning of a statute of Maine,[2] making each stockholder of a bank liable, upon the expiration of the charter, for the redemption of all unpaid bills, in proportion to the stock he then holds, the charter expires when an injunction against the further prosecution of business is made perpetual.[3] It is obvious from a reading of the cases that the courts frequently, as in the above cases, treat a corporation as dissolved when it is necessary to do so in order to preserve the rights of creditors, whilst under similar circumstances the corporation would be treated as being still in existence, if to hold it dissolved would lead to a sacrifice of such rights.[4]

§ **3346. Failing to Elect Officers, and Sold out under Execution.**—Of this nature was a *failure to elect trustees* or to transact other business at a regular annual meeting, and the suffering of a sale of all the corporate property under an execution.[5]

§ **3347. Becoming Utterly Bankrupt.**—Under the same rule a manufacturing company, without funds or property, *utterly bankrupt*, which had done no business and exercised none of its powers for some years, was held to be dissolved.[6] So, the liability of the stockholders of a bank, whose charter contained a provision binding their individual property for the ultimate redemption of its bills, arose when the bank refused or ceased to redeem, and was *notoriously and continuously insolvent*. And where such insolvency occurred prior to June 1, 1865, an action against a stockholder, not commenced until January 1, 1870, was barred by the Georgia *stat-*

[1] Blake *v.* Hinkle, 10 Yerg. (Tenn.) 218; People *v.* Runkle, 9 Johns. (N. Y.) 147; Knowlton *v.* Ackley, 8 Cush. (Mass.) 93. Compare Ward *v.* Sea Ins. Co., 7 Paige (N. Y.), 294.

[2] Rev. Stat. Me. 1857, ch. 47, § 46.

[3] Wiswell *v.* Starr, 48 Me. 401; Dane *v.* Young, 61 Me. 160.

[4] *Post*, § 3367, *et seq.*

[5] Slee *v.* Bloom, 19 Johns. (N. Y.) 456; *s. c.* 10 Am. Dec. 273.

[6] Penniman *v.* Briggs, 1 Hopk. Ch. 300; affirming Briggs *v.* Penniman, 8 Cow. 387; *s. c.* 18 Am. Dec. 454.

ute of limitations of March 16, 1869.[1] So, the dissolution of a corporation meant by the Alabama Code of 1867, section 1760, prescribing the time for the accrual of personal liability of stockholders, is a practical, and not a judicially adjudged, dissolution, which is evidenced by insolvency, and the turning over of the corporate assets to a trustee, followed by a complete abandonment of business.[2]

§ **3348. How Fact of Dissolution Pleaded.** — In pleading, it is not necessary to allege the grounds of dissolution; a *general averment* of a dissolution is *enough*.[3] But an averment in a bill in equity that "complainant is informed and believes that the business of said bank has been so fraudulently and negligently managed that no suit at law can be brought against it, as the stockholders have failed and refused to elect directors as required by the charter, and many other acts and doings have taken place contrary to the charter, whereby they are dissolved,"—has been held an insufficient foundation to charge the stockholders individually.[4]

Article II. Necessity of Creditor Exhausting His Remedy at Law.

Section
3351. General rule that creditors must exhaust remedy against corporation before proceeding against stockholder.
3352. Under some theories, even where the liability is said to be primary.
3353. As under the New York Manufacturing Act.
3354. When judgment at law against corporation necessary to let in equitable relief against the stockholders.

[1] Terry *v.* Tubman, 92 U. S. 156. Similarly, see State Sav. Asso. *v.* Kellogg, 52 Mo. 583; Dryden *v.* Kellogg, 2 Mo. App. 87; Perry *v.* Turner, 55 Mo. 418, 427.

[2] McDonnell *v.* Alabama Gold Life Ins. Co., 85 Ala. 401; *s. c.* 5 South. Rep. 120. To the same effect are Chesapeake &c. R. Co. *v.* Griest, 85 Ky. 619; *s. c.* 4 S. W. Rep. 323; Gibbs *v.* Davis, 27 Fla. 531; *s. c.* 8 South. Rep. 633; Mellen *v.* Moline Malleable Iron Works, 131 U. S. 352; *s. c.* 33 L. ed. 178; 9 Sup. Ct. Rep. 781; Barrick *v.* Gifford, 47 Ohio St. 180; *s. c.* 21 Am. St. Rep. 798. So, where the corporation becomes not only insolvent, but a "nominal inert body." Central &c. Asso. *v.* Alabama &c. Co., 70 Ala. 120, 135; *s. c.* 9 Am. Corp. Cas. 8, 15.

[3] Bank of Poughkeepsie *v.* Ibbotson, 24 Wend. (N. Y.) 473; Perry *v.* Turner, 55 Mo. 418.

[4] Blake *v.* Hinkle, 10 Yerg. (Tenn.) 218.

SECTION
3355. Facts not sufficient to dispense with a judgment at law.
3356. Sufficient to exhaust ordinary legal remedies.
3357. Measure of diligence is judgment, *fieri facias*, and *nulla bona*.
3358. Not necessary to exhaust remedy against corporation where liability of stockholder is primary.

SECTION
3359. Further of this subject.
3360. Theory that the liability may be that of a partner and yet secondary.
3361. Theory that the liability is secondary and collateral.
3362. Exceptional rules under which not necessary to recover judgment against corporation.
3363. Whether the return of *nulla bona* is conclusive against the shareholder.

§ 3351. General Rule that Creditors must Exhaust Remedy against Corporation before Proceeding against Stockholder. — The general rule, where the creditor seeks to charge the stockholder in respect of what remains unpaid on his shares, and also where he seeks to enforce against him an individual statutory liability, is, that he must first exhaust his remedy against the corporation.[1] It has been said, in support of this principle, that each stockholder, upon becoming such in a corporation with an individual liability clause in its charter, does so with the understanding that he will not be held to pay individually the debts of the corporation until the corporate assets have been found insufficient.[2]

§ 3352. Under Some Theories, even where the Liability is Said to be Primary. — This rule, as we have seen,[3] has

[1] Bush *v.* Cartwright, 7 Or. 329; Andrews *v.* Vanderbilt, 37 Hun (N. Y.), 468; Swan Land &c. Co. *v.* Frank, 39 Fed. Rep. 456; McClaren *v.* Franciscus, 43 Mo. 452; Chamberlin *v.* Huguenot Co., 118 Mass. 532, 536; Priest *v.* Essex Hat Man. Co., 115 Mass. 380; Cambridge Water Works *v.* Somerville Dyeing Co., 4 Allen (Mass.), 239; Dauchy *v.* Brown, 24 Vt. 197; Wehrman *v.* Reakirt, 1 Cin. Sup. (Oh.) 230; Shellington *v.* Howland, 53 N. Y. 374; affirming *s. c.* 67 Barb. (N. Y.) 14; Blake *v.* Hinkle, 10 Yerg. (Tenn.) 218; Lindsley *v.* Simonds, 2 Abb. Pr. (N. S.) 69; New England Commercial Bank *v.* Newport Steam Factory, 6 R. I. 154; *s. c.* 75 Am. Dec. 688; Lane *v.* Harris, 16 Ga. 217; Thornton *v.* Lane, 11 Ga. 459; Drinkwater *v.* Portland Marine R. Co., 18 Me. 35; Richards *v.* Coe, 19 Abb. N. C. (N. Y.) 79; Richards *v.* Beach, *Id.* 83; Cuykendall *v.* Corning, 88 N. Y. 129; Handy *v.* Draper, 89 N. Y. 334, 335; Bank *v.* Mosser, 14 Hun (N. Y.), 605.

[2] Jackson *v.* Meek, 87 Tenn. 69; *s. c.* 10 Am. St. Rep. 620.

[3] *Ante*, § 3074; also *post*, § 3360.

been held to be the rule, even under those statutes where the liability of the stockholder is *primary*, like that of an original contractor or *partner*,[1] though some courts hold differently.[2] Here, although under many statutes it is tolerated to have an execution against a stockholder upon a judgment against the corporation, yet no instance has been found where this has been allowed, without a previous return of *nulla bona* as to the corporation, or other equivalent evidence of corporate insolvency. The doctrine of these cases is something like this: Although here is a partnership, a creditor must first exhaust the partnership funds, or proceed till he finds none, before he can attach the separate property of the several members.[3]

§ 3353. As under the New York Manufacturing Act. — A very important statute of New York, section 24 of what is called the Manufacturing Act,[4] which imposes a personal liability for debts contracted which are not to be paid within one year, exempts stockholders from the liability, "unless a suit for the collection of such debt shall be brought against such company within one year after the debt shall become due; and no suits shall be brought against any stockholder . . . . until an execution against the company shall have been returned unsatisfied in whole or in part." As elsewhere seen,[5] a dissolution of the corporation dispenses with the necessity of obtaining a judgment against it under this statute, but in that event the creditor may proceed against the stockholders without a judgment.[6] And we shall have occasion to examine another statute of the same State, the New York

[1] Marcy *v.* Clark, 17 Mass. 330; Stone *v.* Wiggin, 5 Met. (Mass.) 316. Compare Stedman *v.* Eveleth, 6 Met. (Mass.) 114; Leland *v.* Marsh, 16 Mass. 389; Perkins *v.* Church, 31 Barb. (N. Y.) 84.

[2] *Post*, § 3358.

[3] Means's Appeal, 85 Pa. St. 75; Dauchy *v.* Brown, 24 Vt. 197. Numerous *statutes* exist affirming this principle, such as: 8 & 9 Vict., ch. 16 (Companies Clauses Consolidation Act, 1845), § 36; Mass. Stat. 1862, ch. 218, §§ 3, 4; Mass. Stat. 1870, ch. 224, §§ 40, 42. See Peele *v.* Phillips, 8 Allen (Mass.), 86.

[4] N. Y. Laws of 1848, ch. 40, § 24.

[5] *Post*, § 3367.

[6] Hardman *v.* Sage, 124 N. Y. 25; *s. c.* 35 N. Y. St. Rep. 54; 26 N. E. Rep. 354. See, also, Handy *v.* Draper, 89 N. Y. 334.

Business Corporation Act of 1875,[1] the language of which requires a judgment and execution returned *nulla bona* against the corporation, before the stockholders can be sued,—though this does not prevent the creditor from *commencing* his action against the stockholder before thus exhausting his remedy against the corporation, though he cannot have *satisfaction* against the stockholder until he has so exhausted his remedy against the company.[2]

§ **3354. When Judgment at Law against Corporation Necessary to Let in Equitable Relief against Stockholders.** The well-known general rule that equity withholds its aid where there is an adequate remedy at law, requires the creditor of a corporation, or one claiming damages against it, to exhaust his remedy against it in a proceeding at law before applying to a court of chancery for its extraordinary aid. This rule has been often applied in cases where creditors of corporations and parties claiming damages against them have sought to proceed in equity against their shareholders. The principle is of peculiar force where the demand of the claimant consists of an *unliquidated demand* against the corporation, *sounding in damages*,—as, for instance, a demand for damages sustained by misrepresentations by the corporation as vendor in a sale of personal property to the plaintiff. In such a case the claim is one which must be litigated in an action at law against the corporation, where the latter will be entitled to a trial by jury, unless the corporation has suffered such a legal dissolution as prevents the prosecution of such an action against it; and the claimant cannot file a bill in equity against stockholders in the first instance, especially in a jurisdiction different from that of the domicile of the corporation, where the corporation cannot be made a defendant.[3] Nor will a mere *de facto dissolution* of a corporation, which is evidenced by its having distributed all its

[1] N. Y. Laws 1875, ch. 611.

[2] Walton *v.* Coe, 110 N. Y. 109; *s. c.* 13 Cent. Rep. 139; 16 N. Y. St. Rep. 866; 17 N. E. Rep. 677; 4 Rail. & Corp. L. J. 377.

[3] Swan Land &c. Co. *v.* Frank, 39 Fed. Rep. 456.

assets among its stockholders, and ceased to make any use of its franchises, be such a dissolution as will dispense with the necessity of prosecuting such an action against it before attacking its stockholders.[1] A statute of Massachusetts giving a remedy in equity was as follows: "When any of the said officers or stockholders are liable, as mentioned in the two preceding sections, for the debts of any such company, the person to whom they are so liable may, instead of the proceedings mentioned in said two sections, have his remedy against the said officers or stockholders by a bill in equity in the Supreme Judicial Court."[2] Under this statute a creditor of a corporation could not maintain a bill in equity against stockholders not being officers of the corporation, to compel payment of his claim, until he had recovered judgment thereon in an action at law against the corporation, although the corporation was joined as a defendant in the bill. It was otherwise where *officers* of the company became liable to creditors under another section of the statute, for a direct action was given against them.[3] The private property of stockholders in corporations created in Maine after February 16, 1836, excepting banking corporations, was not subject to attachment on a writ against the corporation. The creditor was required to obtain judgment against the corporation before he could have his remedy against the stockholders.[4]

§ 3355. Facts not Sufficient to Dispense with a Judgment at Law.—Where the ordinary theory of equitable remedies prevails, under which it is necessary, before resorting to a court of equity, for the complainant to exhaust his remedies in a legal forum,[5] the mere *insolvency* of the corporation does

[1] Swan Land &c. Co. *v.* Frank, 39 Fed. Rep. 456.

[2] Rev. Stat. Mass. 1836, ch. 38, § 31.

[3] Cambridge Water Works *v.* Somerville Dyeing Co., 4 Allen (Mass.), 239.

[4] Drinkwater *v.* Portland Marine Ry., 18 Me. 34, 36.

[5] This theory of procedure still prevails in those States which have a separate court of chancery, and in those States which have a separate chancery jurisdiction, though administered by the same court which administers the common-law jurisdiction, such as the courts of the United States, of Illinois, etc., and even in those jurisdictions

not dispense with the necessity of the creditor reducing his demand to a judgment at law against it before bringing a suit in equity to charge its shareholders.[1] Nor will it be any excuse for not obtaining such a judgment at law that the *charter* has *expired* by limitation, provided the law governing the corporation is such that this fact does not prevent the obtaining of a judgment at law against it.[2] Under ordinary legal theories the *legal dissolution* of a corporation would prevent the obtaining of a judgment at law against it; for, as has been said in a leading case, a judgment can no more be recovered against a dead corporation than against a dead man.[3] But according to the usual theory, a *de facto dissolution* of a corporation,[4] which consists usually in a permanent suspension of its business and abandonment of its franchises, by reason of insolvency, is no obstruction to obtaining a judgment at law against it, and therefore does not relieve the creditor of the necessity of obtaining such a judgment before applying for equitable relief. Perhaps the best exposition of this doctrine is in an early case in Tennessee, where, as is well known, a separate court of chancery and a separate system of chancery jurisdiction have always been kept up.[5]

§ **3356. Sufficient to Exhaust Ordinary Legal Remedies.** — It is not necessary to exhaust *all remedies* against the corpora-

where an attempt has been made to blend legal and equitable remedies under the modern codes of procedure. It is a species of judicial circumlocution, which operates to increase the delay and expense of litigation without increasing the certainty of justice. It is a rule which is kept up in deference to ancient theories which had their origin at a time when the powers of the court of chancery, which rested largely on the prerogative of the King, were being called into activity, on a principle of mere necessity, to supplement the imperfect justice of the courts of common law. To say the very least, there is no sense in keeping up the rule in any case where the demand is *liquidated*, and in such cases it ought to be abolished by legislation. On the general principle that the remedy at law must be exhausted before invoking the aid of equity, see Jones *v.* Green, 1 Wall. (U. S.) 330; Van Weel *v.* Winston, 115 U. S. 228.

[1] Tarbell *v.* Page, 24 Ill. 46.

[2] Andrews *v.* Vanderbilt, 37 Hun (N. Y.), 468.

[3] Mumma *v.* Potomac Co., 8 Pet. (U. S.) 281, 286.

[4] *Ante*, § 3345, *et seq.*

[5] Blake *v.* Hinkle, 10 Yerg. (Tenn.) 218, 220.

tion before proceeding against its stockholders in equity, but only all remedies against it *at law.*[1] It will be generally sufficient for the creditor to show that he has exhausted the ordinary processes of law against the corporation; and this will ordinarily appear by the judgment, execution, and a return of *nulla bona.*[2] On the other hand, this may be *shown as a fact;* and in one case it was held proper to admit evidence that the corporation had no property in the hands of an *assignee* to whom it had made a voluntary assignment, which could be applied in satisfaction of the plaintiff's claim.[3]

§ 3357. Measure of Diligence is Judgment, Fieri Facias, and Nulla Bona. — It may be stated as a general proposition, beyond which the courts have seldom gone, that no greater degree of diligence is required of the creditor in prosecuting his demand against the corporation, before he can proceed against the stockholder, than is implied in the recovery of a judgment against the corporation, the suing out of a writ of *fieri facias* against it, and a return of *nulla bona* thereon.[4] But in many jurisdictions this measure of diligence is required. Thus, in Ohio, so long as a corporation, possessed of property subject to levy and sale on execution, though insufficient to pay all its debts, continues business, a creditor cannot enforce the statutory liability of its stockholders until an execution issued upon a judgment against it has been returned unsatisfied.[5] This return of *nulla bona* is the return of an execution

[1] Masters *v.* Rossie Lead Min. Co., 2 Sandf. Ch. (N. Y.) 301.

[2] An analogous holding is found in a case where it was held that, to fix the liability of a member of a ditching association for debts contracted by the association while he was a member, the creditor need not show that all the means which the association has power to control have been exhausted, if he shows that he has been unable by ordinary process of law to compel payment. Todhunter *v.* Randall, 29 Ind. 275.

[3] Sleeper *v.* Goodwin, 67 Wis. 577; *s. c.* 31 N. W. Rep. 335.

[4] Thornton *v.* Lane, 11 Ga. 459, 514; Bank of United States *v.* Dallam, 4 Dana (Ky.), 574; Baines *v.* Babcock, 95 Cal. 581; *s. c.* 29 Am. St. Rep. 158; 30 Pac. Rep. 776; Baines *v.* Story (Cal.), 30 Pac. Rep. 777.

[5] Barrick *v.* Gifford, 47 Ohio St. 180; *s. c.* 21 Am. St. Rep. 798; 31 Am. & Eng. Corp. Cas. 484; 2 Am. Rail. & Corp. Rep. 690; 23 Ohio L. J. 313; 24 N. E. Rep. 259.

against the corporation unsatisfied *in the county of its home office;* and this is sufficient to justify an action by the judgment creditor against a stockholder personally;[1] and this, (under a Michigan statute) although it may appear that the corporation had property or effects in another county.[2] An analogous doctrine is found in Maine, where the question was as to the right of a levying officer, having an execution against a corporation, to levy it, under a statute, on the property of a stockholder. Here it was held that the return of the levying officer that the corporation had no attachable property, was conclusive; otherwise "it would always be in the power of a corporation to protect the property of its stockholders from being taken to pay its debts, by keeping a small amount of attachable corporate property secreted, so that neither the creditor nor officer could ascertain its existence."[3]

§ 3358. Not Necessary to Exhaust Remedy against Corporation where Liability of Stockholder is Primary. — Whether the creditor must, before proceeding against the stockholders, exhaust the other assets of the corporation,

[1] Bagley *v.* Tyler, 43 Mo. App. 195; Ripley *v.* Evans, 87 Mich. 217; *s. c.* 10 Rail. & Corp. L. J. 250; 49 N. W. Rep. 504.

[2] Ripley *v.* Evans, *supra.*

[3] Chaffin *v.* Cummings, 37 Me. 76, 86. *Additional affidavit of diligence under English Clauses Consolidation Act* 1845, section 36, and practice in respect of the same. See, as to the practice under this statute, Hitchins *v.* Kilkenny &c. R. Co., 10 Com. B. 160; *s. c.* 1 Lown. M. & P. 712; 15 Jur. 336; 20 L. J. Com. P. 31; Burke *v.* Dublin Trunk &c. R. Co., 37 L. J., Q. B. 50; *s. c.* 16 Week. Rep. 107; L. R. 3 Q. B. 47; Edwards *v.* Kilkenny &c. R. Co., 3 Com. B. (N. S.) 786; Nixon *v.* Brownlow, 1 Hurl. & N. 405; Ilfracombe R. Co. *v.* Devon &c. R. Co., L. R. 2 Com. P. 15; Devereux *v.* Kilkenny &c. R. Co., 1 Lown. M. & P. 788; *s. c.* 5 Ex. 834; 14 Jur. 1028; 20 L. J. Ex. 37; Clowes *v.* Brettell, 11 Mees. & W. 461; 2 D. (N. S.) 1020; 7 Jur. 219; 12 L. J. Ex. 302; Mather *v.* National Assurance Asso., 14 Com. B. (N. S.) 676; Wyatt *v.* Darenth Valley R. Co., 2 Com. B. (N. S.) 110; Rastrick *v.* Derbyshire &c. R. Co., 9 Ex. 149; *s. c.* 7 Rail. Cas. 799; 17 Jur. 977; 23 L. J. Ex. 2; Regina *v.* Derbyshire &c. R. Co., 3 El. & Bl. 784; *s. c.* 18 Jur. 1054; 23 L. J., Q. B. 333; Meader *v.* Isle of Wight Ferry Co., 9 Week. Rep. 750; Bradley *v.* Eyre, 11 Mees. &W. 432; *s. c.* 1 Dowl. & L. 260; 12 L. J. Ex. 450; Bradley *v.* Urquhart, 2 D. (N. S.) 1042; Peddell *v.* Gwyn, 1 Hurl. & N. 590; *s. c.* 3 Jur. (N. S.) 188; 26 L. J. Ex. 199; Bradley *v.* Warburg, 11 Mees. & W. 452; 2 D. (N. S.) 1059; 12 L. J. Ex. 458; Marson *v.* Lund, 16 Ad. & El. (N. S.) 344; *s. c.* 15 Jur. 966; 20 L. J. Q. B.

depends upon the relation in which the governing statute places the stockholders of the corporation to their creditors; and this relation is generally either that of *principal debtors* or that of *sureties*. The general, though not the universal,[1] rule is, that *where the member is liable as a partner or principal debtor*, it is not necessary, as a condition precedent to the right to proceed against him, that the creditor should have first exhausted his remedy against the corporation. In such cases the members are responsible to the same extent and in the same manner as though there were no act of incorporation, and no attempt to organize as a corporation under a general law;[2] for such a liability is *primary* and *absolute*, and attaches the moment the debt is created.[3] Such is the rule where the charter contains a proviso that nothing herein contained shall exempt the members from "all liabilities pertaining to general partners."[4] It has been ruled in Georgia, that if a bank, whose charter makes the stockholders personally liable, makes *an assignment*, which is ratified by the Legislature, of sufficient assets to redeem its circulation, which assets are afterwards wasted, so that on *fieri facias* against the assignee, in favor of a billholder, *nulla bona* is returned, the stockholders are not discharged, but such billholder may immediately have recourse to them for payment. The stockholders, in such case, do not occupy towards the billholders the position of mere sureties, who are discharged by the billholders' neglect

190; Bill *v.* Richards, 2 Hurl. & N. 311; *s. c.* 3 Jur. (N. S.) 520; 26 L. J. Ex. 409; Phillipson *v.* Egremont, 6 Ad. & El. (N. S.) 587; 8 Jur. 1164; 14 L. J. Q. B. 25; Bartlett *v.* Pentland, 1 Barn. & Adol. 704.

[1] *Ante*, § 3074.

[2] Allen *v.* Sewall, 2 Wend. (N. Y.) 327.

[3] Coleman *v.* White, 14 Wis. 700; *s. c.* 80 Am. Dec. 797.

[4] Planters' Bank *v.* Bivingsville &c. Co., 10 Rich. L. (S. C.) 95. The following holdings more or less closely illustrate this theory: Moss *v.* McCullough, 7 Barb. (N. Y.) 279; Moss *v.* Averell, 10 N. Y. 449; Moss *v.* Oakley, 2 Hill (N. Y.), 265; Moss *v.* McCullough, 5 Hill (N. Y.), 131; Mokelumne *v.* Woodbury, 14 Cal. 265; New England &c. Bank *v.* Newport &c. Factory, 6 R. I. 154; *s. c.* 75 Am. Dec. 688; Cornung *v.* McCullough, 1 N. Y. 47; *s. c.* 49 Am. Dec. 287; Worrall *v.* Judson, 5 Barb. (N. Y.) 210; Abbott *v.* Aspinwall, 26 Barb. (N. Y.) 202; Coleman *v.* White, 14 Wis. 700; *s. c.* 80 Am. Dec. 797; Erickson *v.* Nesmith, 46 N. H. 371.

to prevent the waste. They should have prevented it themselves.[1] So, under section 322 of the Civil Code of California, it is that of principal debtors. It follows that a creditor, in a case to which that statute is applicable, is not obliged, before proceeding against a stockholder, to exhaust the funds of the corporation; and he may proceed against the stockholder, even though he hold in his own hand unexhausted assets of the corporation which have been delivered to him in pledge as a security for his debt.[2]

§ **3359. Further of this Subject.** — So, in Alabama, where the statute provides "that for all debts that shall be due and owing by the company at the time of its dissolution, the persons then comprising such company shall be individually responsible to the extent of their respective shares of stock in the said company, and no further."[3] It is held, following the theory of the New York courts, that when the corporation is dissolved, the liability of the stockholders becomes primary and absolute; that this renders it unnecessary first to obtain a judgment at law against the corporation,[4] or, in a suit in equity to enforce the liability of stockholders, to aver or prove the insolvency of the corporation. The construction of the provisions of the Alabama Constitution, and of a statute making the stockholders of corporations liable to the extent of their stock for the debts of the corporation existing at the time of its dissolution, which is held to mean a superadded

[1] Robinson *v.* Lane, 19 Ga. 337.

[2] Sonoma Valley Bank *v.* Hill, 59 Cal. 107; *s. c.* 9 Am. Corp. Cas. 20. In this State it is said that the stockholders are not sureties, but principal debtors. Their liability is not extinguished or suspended or merged by a judgment against the corporation. The remedy against the latter may be suspended, or perhaps barred, without impairing that against the stockholders, because the liability of the latter is primary, and ceases only when the debt is satisfied or extinguished as to the corporation. Young *v.* Rosenbaum, 39 Cal. 646.

[3] 2 Rev. Stat. Ala. 1859, p. 654, § 7.

[4] Spence *v.* Shapard, 57 Ala. 598; McDonnell *v.* Alabama Gold Life Ins. Co., 85 Ala. 401; *s. c.* 5 South. Rep. 120. See, also, Central Agricultural &c. Asso. *v.* Alabama Gold Life Ins. Co., 70 Ala. 120, where the complainant, suing in behalf of himself and all the other creditors who might come in and make themselves parties, was not himself a judgment creditor.

individual liability, dispenses with the necessity of either a judgment at law or a lien upon the corporate assets, but extends the remedy to simple contract creditors.[1] So, in an act incorporating a manufacturing company, it was provided that *the persons and property of the members of the corporation should, at all times, be liable for all debts due by said corporation.* A creditor brought his action of debt against the corporation, obtained judgment, and took out execution, on which there was a return of *nulla bona.* He then brought a *scire facias* against the individual members of the corporation, stating the previous proceedings. It was held that such *scire facias* would not lie, the members being original debtors, and liable in the same manner as though there had been no incorporation.[2] But as this case stands on a peculiar statute, and is almost alone in its conclusion, it can scarcely be considered authority. It agrees in one respect with cases decided under the early Massachusetts statutes.[3] Here no *scire facias* or other process against the individual member was allowed, but he was charged, at the peril of the creditor, on the same process which issued against the corporation.[4]

§ 3360. Theory that the Liability may be that of a Partner and yet Secondary.—Again, we find statutes under which the liability of the stockholder is declared to be *primary*, in the sense which distinguishes it from the liability of a surety or guarantor;[5] and also in the sense that the foundation of their liability consists in the original demand against the company, and not in the judgment which the creditor has obtained against it;[6] and in the further sense which makes them liable as original debtors at the instant when the con-

[1] McDonnell *v.* Alabama Gold Life Ins. Co., *supra.*

[2] Southmayd *v.* Russ, 3 Conn. 52.

[3] Stat. Mass. 1808, ch. 65, § 6; Stat. Mass. 1817, ch. 183.

[4] Leland *v.* Marsh, 16 Mass. 389; Marcy *v.* Clark, 17 Mass. 330; Stone *v.* Wiggin, 5 Met. (Mass.) 316, 318.

[5] Hyman *v.* Coleman, 82 Cal. 650; *s. c.* 16 Am. St. Rep. 178; 23 Pac. Rep. 62; Mokelumne &c. Co. *v.* Woodbury, 14 Cal. 265; Young *v.* Rosenbaum, 39 Cal. 646.

[6] Such was the liability under a statute of New York relating to joint-stock companies. Witherhead *v.* Allen, 4 Abb. App. Dec.(N.Y.) 628.

tract with the corporation is completed.[1] And yet, in these cases, the courts recognize the principle that the liability, in a remedial sense, is secondary to that of the corporation, — that is, the creditor is not permitted, in ordinary cases, to ignore the corporation and proceed directly against the stockholder, but must proceed first against the corporation, and exhaust his remedy there, and then proceed against the stockholder.

§ 3361. Theory that the Liability is Secondary and Collateral. — The more usual theory of the individual or superadded liability of stockholders, which is created in much the same terms by many statutes, is, that it is a liability which is *secondary* or *collateral* to that of the corporation, to be resorted to by creditors only in case of the insolvency of the corporation, or when payment could not be enforced against it by the ordinary process.[2] It has been so held under statutes which subjected the personal property of the individual members of the corporation to execution for the payment of the corporate debts.[3] The Supreme Court of North Carolina conceded so much to the infirm technicality of the ancient law as to hold that, under a provision in an act of incorporation, that "the private property of the individual stockholders shall be liable for the debts, contracts, and liabilities of the corporation," the responsibility imposed on the individual stockholders is a secondary one, and that when the debts against the corporation become *extinct* by the expiration of its charter, the liability of the individual stockholders becomes *extinct* also.[4] But this is not the law.[5] A case in Pennsylvania holds that the liability of stockholders, under a statute of that State passed in 1853, is secondary, not primary; collateral, not principal; analogous to a case of guaranty, to be enforced if the regular process in the principal contract proves fruitless, or if the corporation becomes insolvent. The

[1] Conklin *v.* Furman, 57 Barb. (N. Y.) 484.

[2] Nimick *v.* Mingo Iron Works Co., 25 W. Va. 184.

[3] Pratt *v.* Bacon, 10 Pick. (Mass.) 123, 127; Dauchy *v.* Brown, 24 Vt. 197.

[4] Mallory *v.* Mallett, 6 Jones' Eq. (N. C.) 345.

[5] *Ante*, § 3341; *post*, ch. 156.

result deduced from this doctrine is that, the statute not having prescribed any form of proceeding, the court will apply the remedy usual against guarantors, and will entertain separate actions against the primary and secondary debtors.[1]

§ 3362. Exceptional Rules under Which not Necessary to Recover Judgment against Corporation. — Although under the statute of Pennsylvania[2] the corporation is the principal debtor, and the liability of the stockholder is only secondary and collateral, yet it is not necessary to recover a judgment against the corporation before suing the stockholder.[3] Both may be joined in the suit on the original contract.[4] So, under the New York Business Corporations Act,[5] an action may be maintained to enforce a stockholder's liability pending an action against the corporation, and before judgment therein.[6] So, a creditor might maintain, under an earlier statute of New York,[7] a direct action against a stockholder to recover the amount unpaid on his shares, without showing judgment recovered by him against the corporation, and an execution returned unsatisfied.[8]

§ 3363. Whether the Return of Nulla Bona is Conclusive against the Shareholder. — But where the shareholder in a bank was proceeded against at law, under a provision of the charter making shareholders liable for the ultimate

[1] Patterson *v.* Wyomissing &c. Co., 40 Pa. St. 117.

[2] 2 Brightly's Purd. Dig. 998, § 30.

[3] Patterson *v.* Wyomissing Co., 40 Pa. St. 117.

[4] *Post,* § 3503.

[5] Laws N. Y. 1875, ch. 611.

[6] Following Walton *v.* Coe, 110 N. Y. 109; *s. c.* 17 N. E. Rep. 676; Young *v.* Brice, 3 N. Y. Supp. 123. Section 25 of this statute, which exempts the stockholders of business corporations organized under that act from liability in certain cases, is identical with section 24 of the Act of 1848, except that it omits the provision of the Act of 1848, that the stockholders shall not be liable "until an *execution* issued against the company shall have been returned unsatisfied." It is held that an action can be maintained against the stockholders of a corporation organized under the Act of 1875, though no execution has been issued against the company. Richards *v.* Beach, 5 N. Y. Supp. 574.

[7] Laws N. Y. 1848, ch. 40, §§ 10, 24.

[8] Handy *v.* Draper, 23 Hun (N.Y.), 256; overruling Lindsley *v.* Simmonds, 2 Abb. Pr. (N.S.) (N. Y.) 256. See *ante,* § 3358.

redemption of their proportion of the bills of the bank, the Supreme Court of Georgia, after carefully balancing the question, concluded that the most reasonable rule was that a return of *nulla bona* should not be considered conclusive against the shareholder, unless due and proper notice had been previously given him, to the end that he might, if he chose, point out corporate property.[1] In an earlier case in the same State — an action at law against a stockholder in the same bank — the declaration alleged a judgment against the assignee of the bank and a return of *nulla bona.* A plea that the bank had assets, but without specifying what they were, was held void for uncertainty.[2] In Michigan, on the other hand, where, in a proceeding to enforce the individual liability of a stockholder, the defendant insisted that he ought to have been permitted to show, notwithstanding the sheriff's return, that the corporation had property situated within the county, — claiming that such property consisted of the *franchises* of the company which were subject to levy and sale on execution, — the court disposed of the question by saying that "the sheriff's return upon that question, as between these parties, is conclusive."[3]

[1] Lane *v.* Harris, 16 Ga. 217, 224.

[2] Lane *v.* Morris, 8 Ga. 468.

[3] Ripley *v.* Evans, 87 Mich. 217; *s. c.* 10 Rail. & Corp. L. J. 250; 49 N. W. Rep. 504. The court in this case merely cited the previous decision in the same court in Michels *v.* Stork, 52 Mich. 260. In this last case an action of trover was brought against the plaintiff in an attachment for seizing the goods of the plaintiff in the action of trover; and the question was, whether the return of the constable who executed the attachment was *prima facie* evidence in favor of the defendant in the action of trover (plaintiff in the attachment suit), or whether it was conclusive evidence. The trial court charged that it was *prima facie* evidence only; but the supreme court (Campbell, J., dissenting) held that it was conclusive until impeached by a direct proceeding, and accordingly reversed the judgment. As the opinion contains a valuable collection of decisions on the question of the conclusiveness of sheriffs' returns, and as it was written by a judge of great eminence, it is proposed to copy here the argumentative part of it. Mr. Justice Cooley said: "The purport of this instruction is, that the return is to be taken as *prima facie* evidence of the facts stated in it, but that it may be contradicted by parol evidence, and if the jury are convinced by such evidence that the return is untrue, they are at liberty to disregard it; and the jury in this case did disregard it, and gave judgment for the plaintiff, grounding their action upon a finding that no attachment had in fact ever been made. Had the suit been

So, in California, the action was by a judgment creditor of a corporation against certain stockholders, to subject to the satisfaction of his judgment certain unpaid balances due by them on their subscriptions for shares in the company, and

brought against the officer for a false return, it is conceded that the plaintiff would have been at liberty to show the falsity of the return by any evidence fairly tending to show it. He might do this also by an affidavit on a motion in the same suit to set aside the return; and this is not an uncommon proceeding when the truth of the return is disputed. Chapman *v.* Cumming, 17 N. J. L. 11; Carr *v.* Commercial Bank, 16 Wis. 52; Bond *v.* Wilson, 8 Kan. 228; *s. c.* 12 Am. Rep. 466. It has also been held that the officer's return may be contradicted in equity in a proceeding instituted to set aside a judgment founded upon it. Owens *v.* Ranstead, 22 Ill. 161; Newcomb *v.* Dewey, 27 Iowa, 381; Bridgeport Sav. Bank *v.* Eldredge, 28 Conn. 556; *s. c.* 73 Am. Dec. 688; Bell *v.* Williams, 1 Head (Tenn.), 229; Ridgeway *v.* Bank of Tennessee, 11 Humph. (Tenn.) 523. See Fowler *v.* Lee, 10 Gill & J. (Md.) 358; *s. c.* 32 Am. Dec. 172; Leftwick *v.* Hamilton, 9 Heisk. (Tenn.) 310. It is also held that the officer's return is not conclusive as to facts stated therein which he must learn by inquiry of others: as, for example, that the person upon whom the process was served was the incumbent of a certain corporate office, such as that of president of a bank. St. John *v.* Tombeckbee Bank, 3 Stew. (Ala.) 146; Rowe *v.* Table &c. Co., 10 Cal. 441; Wilson *v.* Spring &c. Co., 10 Cal. 445. See Chapman *v.* Cumming, 17 N. J. L. 11; Sanford *v.* Nichols, 14 Conn. 324. And compare State *v.* O'Neill, 4 Mo. App. 221. And a person not a party or privy to the proceeding in which the return is made is never concluded by it from showing the real fact. Nall *v.* Granger, 8 Mich. 450; *s. c.* 77 Am. Dec. 462. And where suit is brought upon a foreign judgment, it seems to be competent to disprove jurisdiction by showing, in contradiction of the officer's return, that no service was made upon the party defendant. Knowles *v.* Gaslight &c. Co., 19 Wall. (U. S.) 58; Thompson *v.* Whitman, 18 Wall. (U. S.) 457; Carleton *v.* Bickford, 13 Gray (Mass.), 591, 596; *s. c.* 74 Am. Dec. 652; McDermott *v.* Clary, 107 Mass. 501; Gilman *v.* Gilman, 126 Mass. 26; *s. c.* 30 Am. Rep. 646; Bowler *v.* Huston, 30 Gratt. (Va.) 266; *s. c.* 32 Am. Rep. 673; Lowe *v.* Lowe, 40 Iowa, 220. None of these cases are analogous to the one before us; but it must be conceded that there are cases which are directly in point, and which tend to support the instructions. Cunningham *v.* Mitchell, 4 Rand. (Va.) 189; Butts *v.* Francis, 4 Conn. 424; Watson *v.* Watson, 6 Conn. 334; Hutchins *v.* Johnson, 12 Conn. 376; *s. c.* 30 Am. Dec. 622; Smith *v.* Law, 5 Ired. L. (N. C.) 197; Joyner *v.* Miller, 55 Miss. 208; Abell *v.* Simon, 49 Md. 318; Gary *v.* State, 11 Tex. App. 527; Dasher *v.* Dasher, 47 Ga. 320; Elder *v.* Cozart, 59 Ga. 199; Jones *v.* Commercial Bank, 5 How. (Miss.) 43; *s. c.* 35 Am. Dec. 419. The Georgia cases appear to be based upon a statute. If it were important now to examine the other cases critically, some of them might perhaps be distinguished, but their tendency is unquestionably as above stated. On the other hand,

it was pleaded and proved that execution had been issued upon the plaintiff's judgment, and by the sheriff returned unsatisfied, because he could find no property of the corporation to apply to its satisfaction. In opposition to this, the

the ruling of this court, in Green *v.* Kindy, 43 Mich. 278, is distinctly adverse to the instructions. It was there held that the return of a sheriff to a writ of replevin, in which he certified that the plaintiff in the suit had not filed a forthcoming bond, was conclusive upon the parties, and would preclude any such bond being set up. This case, which seems to have been overlooked on the trial, is in entire accord with the English authorities. Anonymous, Lofft, 372; Bentley *v.* Hore, 1 Lev. 86; Flud *v.* Penington, Cro. Eliz. 872; Rex *v.* Elkins, 4 Burr. 2129; Harrington *v.* Taylor, 15 East, 378; Goubot *v.* De Crouy, 2 Dowl. P. C. 86. But it is also in accord with the great preponderance of authority in this country. In New York, the doctrine was strongly asserted in a case in which a constable had served his own process, which the law of that State allowed. The 'constable's return,' says the court, 'is conclusive against the defendant in the cause in which it is made. He cannot traverse the truth of it by a plea in abatement or otherwise; but if it be false the defendant's remedy is in an action against the constable for a false return.' See Allen *v.* Martin, 10 Wend. (N. Y.) 300; *s. c.* 25 Am. Dec. 564; Boomer *v.* Laine, 10 Wend. (N. Y.) 525. In Pennsylvania, it was said in an early case: 'It is a well-settled principle, applicable to every case, that credence is to be given to the sheriff's return; so much so that there can be no averment against it in the same action. A party may make an averment consistent with the sheriff's return, or explanatory of its legal bearing and effect, where the return is at large; but he cannot aver a matter directly at variance with the facts stated in the return, and contradictory to it, and showing it to be false. If a party be injured by the false return of the sheriff, his remedy is by action on the case against the sheriff who makes it.' Knowles *v.* Lord, 4 Whart. (Pa.) 500; *s. c.* 34 Am. Dec. 525. Like decisions were made in Zion Church *v.* St. Peter's Church, 5 Watts & S. (Pa.) 215; Diller *v.* Roberts, 13 Serg. & R. (Pa.) 60; *s. c.* 15 Am. Dec. 578; and the doctrine is recognized in Paxson's Appeal, 49 Pa. St. 195. It has also been distinctly and strongly affirmed in Massachusetts cases. Slayton *v.* Chester, 4 Mass. 478; Bott *v.* Burnell, 11 Mass. 163; Winchel *v.* Stiles, 15 Mass. 230; Bean *v.* Parker, 17 Mass. 591; Campbell *v.* Webster, 15 Gray (Mass.), 28; Dooley *v.* Wolcott, 4 Allen (Mass.), 406. In New Hampshire, it is said: 'As between the parties, the return of the sheriff is conclusive upon all matters material to be returned, and cannot be contradicted by such parties or their privies, or by bail, indorsers, or others, whose rights or liabilities are dependent upon the suit. The remedy for a false return is by suit against the sheriff, and not by defeating the proceedings in which such return is made.' Bolles *v.* Bowen, 45 N. H. 124 (following Brown *v.* Davis, 9 N. H. 76); Wendell *v.* Mugridge, 19 N. H. 109, 112; Angier *v.* Ash, 26 N. H. 99; Messer *v.* Bailey, 31 N. H. 9; Clough *v.* Monroe, 34 N. H. 381. To the same purport are the Kentucky cases: Trigg *v.* Lewis, 3 Litt. (Ky.) 129; Smith *v.* Hornback, 3 A. K. Marsh. (Ky.) 379. In Vermont and Maine, the cases in

defendant offered to show that the corporation was an owner, and in possession of, a large number of street-cars, and other personal property, and of valuable franchises, within the county in which the action had been brought. The trial court ruled that this could not be shown in opposition to the sheriff's return, and the supreme court affirmed the ruling.[1] In this last case the California court quoted the language used by Mr. Justice Field, in giving the opinion of the Supreme Court of the United States, in a case where judgment creditors of an *individual* were prosecuting a suit in equity to set aside a fraudulent conveyance of his property, and subject it to their judgment. The answer denied that execution had been issued and returned unsatisfied, and there was no sufficient proof to the contrary. The learned justice said: "The objection that the complainants have not shown any attempt to enforce their remedy at law is fatal to the relief prayed. A court of equity exercises its jurisdiction in favor of a judgment creditor only when the remedy afforded him at law is

Massachusetts have been followed with approval. Eastman *v.* Curtis, 4 Vt. 616; Swift *v.* Cobb, 10 Vt. 282; Wood *v.* Doane, 20 Vt. 612; Stratton *v.* Lyons, 53 Vt. 130; Gilson *v.* Parkhurst, 53 Vt. 384; Stinson *v.* Snow, 10 Me. 263; *s. c.* 25 Am. Dec. 238; Fairfield *v.* Paine, 23 Me. 498; *s. c.* 41 Am. Dec. 357. The decisions in Indiana are to the same effect. Howell *v.* Klein, 44 Ind. 290; *s. c.* 15 Am. Rep. 235; Splahn *v.* Gillespie, 48 Ind. 397; Stockton *v.* Stockton, 59 Ind. 574; Clark *v.* Shaw, 79 Ind. 164. So are those in North Carolina, Arkansas, Minnesota, and Nebraska. Hunter *v.* Kirk, 4 Hawks (N. C.), 277; Rose *v.* Ford, 2 Ark. 26; Tullis *v.* Brawley, 3 Minn. 277; Johnson *v.* Jones, 2 Neb. 126. In Illinois, the English rule has been recognized: Fitzgerald *v.* Kimball, 86 Ill. 396; though it is said that some exceptions are made to it in the furtherance of justice in that State. Ryan *v.* Lander, 89 Ill. 554. What the exceptions are is not pointed out in that case, but in the subsequent case of Hunter *v.* Stoneburner, 92 Ill. 75, 79, we have the following statement, as the result of prior decisions: 'It is in rare cases only that the return of the officer can be contradicted, except in a direct proceeding, by suit against the officer for a false return. In all other cases, almost without an exception, the return is held to be conclusive. An exception to the rule is, where some other portion of the record in the same case contradicts the return, but it cannot be done by evidence *dehors* the record.' These citations are sufficient, and more than sufficient, to justify the previous ruling by this court. It follows that the instruction complained of was erroneous, and it must be reversed with costs, and new trial ordered."

[1] Baines *v.* Babcock, 95 Cal. 581, 591; *s. c.* 29 Am. St. Rep. 158.

ineffectual to reach the property of the debtor, or the enforcement of the legal remedy is obstructed by some incumbrance upon the debtor's property, or some fraudulent transfer of it. In the first case, the court, when its aid is invoked, looks only to the execution, and the return of the officer to whom the execution was directed. The execution shows that the remedy afforded at law has been pursued, and, of course, is the highest evidence of the fact. The return shows whether the remedy has proved effectual or not; and from the embarrassments which would attend any other rule, the return is held conclusive. The court will not entertain inquiries as to the diligence of the officer in endeavoring to find property upon which to levy. If the return be false, the law furnishes to the injured party ample remedy."[1]

Article III. What Will Excuse this Necessity.

Section
3367. Dissolution of the corporation.
3368. Appointment of a receiver.
3369. *De facto* dissolution not sufficient where the claim sounds in damages.
3370. Failure to comply with statutory requirements so as to become incorporate.
3371. Either corporation must be insolvent generally, or creditor must have exhausted his remedies against it.

§ **3367. Dissolution of the Corporation.** — Stated in general terms, and subject to exceptions elsewhere considered, the *dissolution* of a corporation, whether legal or *de facto*,[2] renders it either impossible or unnecessary for the creditor to prosecute his demand to a judgment at law against it before proceeding to charge its stockholders. A legal dissolution, in the absence of a saving statute, renders it impossible for him to prosecute his judgment against the corporation; because, as already stated, a judgment can no more be rendered against a dead corporation than against a dead person.[3] A *de facto* dissolution,

[1] Jones *v.* Green, 1 Wall. (U. S.) 330, 332. That this principle is applicable to creditors of corporations, see Van Weel *v.* Winston, 115 U. S. 228, 245.

[2] *Ante*, § 3345.

[3] Mumma *v.* Potomac Co., 8 Pet. (U. S.) 281, 287, *per* Story, J.; Hardman *v.* Sage, 124 N. Y. 25, 34; *s. c.* 26 N. E. Rep. 354; Arnot *v.* Sage, 5 N. Y. Supp. 477.

under many theories, renders it unnecessary, because nugatory;[1] and we shall see that there are, in many jurisdictions and under many theories, other ways of proving that the corporation has no assets available to satisfy its creditors than a judgment, an execution and a return of *nulla bona;*[2] though when the fact is proved by such a return, that, in most jurisdictions, is conclusive.[3] The courts which dispense with the necessity of a judgment at law, where there has been a *de facto* dissolution by reason of insolvency, proceed upon the well-known principle that *the law does not require a man to do a vain thing;* "and, therefore, where the company has become wholly insolvent," says Minshall, C. J., speaking for the Supreme Court of Ohio, "has ceased to do business, and assigned all its property to a trustee for the benefit of its creditors, the suit to enforce their statutory liability may be commenced against the stockholders by the creditors, without any of them first recovering a judgment against the company, and having an execution issued and returned unsatisfied."[4]

[1] Shellington *v.* Howland, 53 N. Y. 371; affirming *s. c.* 67 Barb. (N. Y.) 14 (with which compare Kincaid *v.* Dwinelle, 59 N. Y. 548; affirming *s. c.* 37 N. Y. Supp. 326); Barrick *v.* Gifford, 47 Ohio St. 180; *s. c.* 21 Am. St. Rep. 798. See Renolds *v.* Cridge (Pa. C. P.), 11 Pa. Co. Ct. 306.

[2] *Post*, § 3368.

[3] *Ante*, § 3363.

[4] Barrick *v.* Gifford, 47 Ohio St. 180, 184; *s. c.* 21 Am. St. Rep. 798; 31 Am. & Eng. Corp. Cas. 484; 2 Am. Corp. Rep. 690; 23 Ohio L. J. 313; 24 N. E. Rep. 259; following Morgan *v.* Lewis, 46 Ohio St. 1; *s. c.* 17 N. E. Rep. 558; 15 West. Rep. 445; 20 Ohio L. J. 423. At the same time it is conceded by the same court that where a corporation, possessed of property subject to levy and sale on execution, though not sufficient to pay all its debts, continues to transact its business, the right of a creditor to enforce the statutory liability of its stockholders does not accrue until an execution, issued upon a judgment against it, has been returned unsatisfied for want of goods whereon to levy. Barrick *v.* Gifford, *supra.* Expressions are found in the books which are sometimes seized upon in support of the same doctrine, but the reader should be cautioned against the use of them, except where the precise question was under consideration by the court. Of this nature is the following language, found in an opinion of the Supreme Court of the United States, delivered by Mr. Justice Bradley, and reaffirmed in a subsequent opinion of the same court: "When a corporation becomes insolvent, it is so far civilly dead that its property may be administered as a trust fund for the benefit of its stockholders and creditors. A court of equity, at the instance of the proper parties, will then make those funds trust funds, which, in other circumstances, are as much the absolute

§ 3368. And so does the Appointment of a Receiver.—The appointment of a receiver, in a proceeding to wind up the affairs of a corporation, will generally have the effect of preventing the prosecution by separate creditors of their statutory remedies against particular shareholders,—the theory of many courts being, as hereafter seen, that not only the indebtedness of the shareholder to the company, in respect of any unpaid portion of his subscription for his shares, but also his superadded statutory liability, is in the nature of equitable assets of the corporation, which pass into the hand of the receiver for administration; and this necessarily excludes the right of creditors to prosecute separate suits against stockholders.[1] The creditors must, according to the ordinary practice in chancery, intervene *pro interesse suo,* and prove up their claims before the receiver; and this seems to dispense with the necessity of prosecuting their claims to judgment at law, at least where they have not commenced their actions against the corporation prior to the appointment of the receiver. In case of a contest of the claim, which the receiver would be entitled to make, not only as representing the stockholders, but as representing other creditors, the case would go to a master or referee, and a confirmation of his finding by the court would be in the nature of a judgment at law. On the other hand, the mere fact that a proceeding has been commenced to dis-

property of the corporation as any man's property is his." Graham *v.* Railroad Co., 102 U. S. 148, 161; requoted by Mr. Justice Harlan, in giving the opinion of the court in Mellen *v.* Moline Iron Works, 131 U. S. 352, 366. In neither of these cases was the question treated of in the text under consideration by the court; and the court did not mean to decide that the mere insolvency of the company dispensed with the necessity of the creditor reducing his demand to a judgment at law, unless there has been a judicial or other assignment for the benefit of its creditors. The court did decide, however, in the last-named case (131 U. S. 352, 367) that the fact that the creditor has so proceeded without first reducing his claim to a judgment at law is not a *jurisdictional* defect which can be availed of collaterally, but that, at most, it is legal error, which must be corrected in that proceeding.

[1] Showalter *v.* Laredo Imp. Co., 83 Tex. 162; *s. c.* 18 S. W. Rep. 491; Merchants' Nat. Bank *v.* Northwestern Man. &c. Co., 48 Minn. 361; *s. c.* 51 N. W. Rep. 119; Paine *v.* Stewart, 33 Conn. 516, 531.

solve and wind up the corporation, and that a receiver has been appointed in such proceeding, will not of itself prevent the prosecution of an action by a creditor *against the corporation*, until an injunction has been issued against the prosecution of such actions:[1] the principle being that to effect the dissolution of a corporation for all purposes, there must be, — at least in cases where its charter has not expired by limitation, or been repealed by the Legislature, under a reservation of the right of repeal, — a judgment of a court of competent jurisdiction declaring it dissolved; and that, until the rendition of such a judgment, creditors may proceed by suit against the corporation, unless restrained by injunction.[2] From this it equally follows that, whether the theory be adopted that the commencement of proceedings to dissolve and wind up the corporation, and the appointment of a receiver thereunder, dispense with the necessity of creditors reducing their claims to judgments at law against the corporation, or whether the view is taken that they ought to proceed by suit against the corporation until enjoined, the creditor who has so proceeded in the absence of an injunction against him, and who has reduced his demand to a judgment at law against the corporation, is not in a worse position than where he has not done so, but has relied upon his supposed right of presenting his claim to the receiver for allowance. In either case his position is firm and secure. If the view be taken that the corporation was *ipso facto* dissolved by the appointment of a receiver, then this rendered it impossible for him to prosecute his claim to a *valid* judgment, such as would be evidence to charge a stockholder; and this, under the principle of the preceding section, would exonerate him from the necessity of prosecuting his claim to judgment. If, on the other hand, the corporation had not so become dissolved, his judgment would be effectual and evidentiary against the stockholders,

[1] Kincaid *v.* Dwinelle, 59 N. Y. 548, 551; affirming *s. c.* 37 N. Y. Sup. Ct. 326.

[2] People *v.* Manhattan Co., 9 Wend. (N. Y.) 351; Re Reformed Presbyterian Church, 7 How. Pr. (N. Y.) 476; Mickles *v.* Rochester City Bank, 11 Paige (N. Y.), 118; *s. c.* 42 Am. Dec. 103; Kincaid *v.* Dwinelle, *supra.*

and his position would be equally clear.[1] But where the statute provided "that all proceedings to enforce the liability of a stockholder for the debts of a corporation shall be either by suit in equity, conducted according to the practice and course of equity, or by an action of debt upon the judgment obtained against such corporation; and in any such suit or action, such stockholder may contest the validity of the claim upon which the judgment against such corporation was obtained, upon any ground upon which such corporation could have contested the same in the action in which such judgment was recovered,"[2] — it was held that a creditor could not maintain an action against a stockholder without first reducing his demand to a judgment against the corporation, and making that judgment the foundation of his action against the stockholder; and that the fact that the corporation had been *adjudged a bankrupt* did not dispense with this requirement.[3]

§ 3369. De Facto Dissolution not Sufficient where the Claim Sounds in Damages. — Where the demand of the claimant against the corporation is an unliquidated demand sounding in damages, as, for instance, a claim for damages for misrepresentations made by the corporation, as vendor, in a sale of chattels to the claimant, — in other words, where the claimant's demand is one which, from its very nature, ought to be *established by the verdict of a jury*, and on which the corporation is entitled, under constitutional principles, to the verdict of a jury,— he ought not to be allowed to make it the basis of a proceeding against stockholders in the first instance, especially in a jurisdiction other than that of the residence of the corporation, where the corporation cannot be made a party; but he ought to be required to reduce his demand to a judgment in the first instance, by an action at law against

[1] This is clearly brought out by Allen, J., in Kincaid *v.* Dwinelle, 59 N. Y. 548, 551, and his language is quoted with approval in the opinion of the same court in Hardman *v.* Sage, 124 N. Y. 25, 33; *s. c.* 26 N. E. Rep. 354.

[2] R. I. Act of March 27, 1877, ch. 600, § 2.

[3] Fourth Nat. Bank *v.* Francklyn, 120 U. S. 747.

the corporation, before seeking the aid of equity in respect of it against its stockholders. Nor does the fact that the corporation has suffered a *de facto* dissolution, by winding up its business, distributing all its assets, and ceasing to use its franchises, dispense with the necessity of so reducing the demand to judgment against it; because, as just seen, this does not of itself prevent the prosecution of an action at law against the corporation. In such a case nothing but a legal dissolution of a corporation for all purposes, such as will prevent the prosecution of an action and the recovery of a judgment against it, will, it has been held by a very able judge, dispense with the necessity of a judgment at law against it.[1] A mere *de facto* dissolution does not have this effect; for the law is well settled that a corporation is not dissolved for all purposes by the mere non-user of its franchises, or the want of assets, or the exhaustion of its assets.[2] For instance, a national bank does not, by passing into liquidation in the hands of a receiver, lose its capacity of suing and being sued.[3]

§ 3370. Failure to Comply with Statutory Requirements so as to Become Incorporate. — Where the privilege of exemption from the ordinary lot of *partners* is granted by the Legislature, on condition that the coadventurers or the corporation shall *comply with certain statutory requirements*,[4] the road is open to a direct action against them by the creditors, as though they had never been or attempted to become incorporated; and they may be sued without the property of the corporation being first exhausted;[5] and even where such a statute[6] requires an execution against the corporation to be returned unsatisfied before execution shall issue against a

[1] Swan Land. &c. Co. *v.* Frank, 39 Fed. Rep. 456, opinion by Blodgett, J.

[2] Boston Glass Manufactory *v.* Langdon, 24 Pick. (Mass.) 49; *s. c.* 35 Am. Dec. 292; *post*, ch. 153.

[3] Bank of Bethel *v.* Pahquioque Bank, 14 Wall. (U. S.) 383; National Bank *v.* Insurance Co., 104 U. S. 54, 73.

[4] As to which, see *ante*, §§ 224, 2969.

[5] Marshall *v.* Harris, 55 Iowa, 182.

[6] Here, New York Laws, 1875, ch. 611, § 37, making stockholders liable for the debts of the corporation to an amount equal to their stock, until the whole amount of the capital stock has been paid in and a certificate thereof filed.

stockholder, this does not prevent *concurrent actions* against the corporation and a stockholder. It merely suspends the remedy of the creditor against the stockholder, after the recovery of his judgment against him, until after judgment against the corporation and execution thereon returned *nulla bona*.[1]

§ 3371. Either Corporation must be Insolvent Generally, or Creditor must have Exhausted His Remedies against It.— The conclusion then is, that under any theory of law or equity, where the liability of the stockholder is not primary, as in the case of a mere partner or original undertaker, one of two things must supervene before a creditor of a corporation will be permitted to proceed against him: 1. Either that the corporation has suspended business by reason of insolvency, and suffered what is called a *de facto* dissolution;[2] or else, although the corporation may not be totally insolvent, and may continue to be what is called a going concern, the creditor must have exhausted his legal remedies against it without procuring the satisfaction of his debt. Accordingly, it is the rule in Ohio that where a corporation, possessed of property subject to levy and sale on execution, though not sufficient to pay all its debts, continues to transact its business, the right of a creditor to enforce the statutory liability of its stockholders does not accrue until an execution, issued upon a judgment against it, has been returned unsatisfied for want of goods whereon to levy; while, if there is such a *de facto* dissolution as is evidenced by a suspension of business by reason of general insolvency, this condition is dispensed with.[3]

[1] Walton *v.* Coe, 110 N. Y. 109; *s. c.* 21 Am. & Eng. Corp. Cas. 646; 17 N. E. Rep. 676; 16 N. Y. St. Rep. 866; 4 Rail. & Corp. L. J. 377; Young *v.* Brice, 18 N. Y. St. Rep. 945; 3 N. Y. Supp. 123.

[2] *Ante*, § 3345; Hospes *v.* Northwestern Man. &c. Co., 48 Minn. 174; *s. c.* 31 Am. St. Rep. 637; 15 L. R. A. 470; 45 Alb. L. J. 277; 36 Am. & Eng. Corp. Cas. 206; 50 N. W. Rep. 1117.

[3] Barrick *v.* Gifford, 47 Ohio St. 180; *s. c.* 21 Am. St. Rep. 798.

ARTICLE IV. OTHER CONDITIONS PRECEDENT.

SECTION
3374. Proving claim before receiver.
3375. Dispenses with necessity for judgment, even where the statute requires a judgment.
3376. Exhausting deposits made with the State.
3377. Exhausting equitable assets before statutory liability.
3378. Exhausting remedy against other judgment debtors of corporation.
3379. Not necessary to exhaust individual liability before subjecting what is due on share subscriptions.
3380. Making demand upon the corporation or its officers.
3381. What necessary to a good demand.
3382. Notifying stockholder of proceeding against corporation.
3383. Giving notice to stockholder of the default of the corporation.
3384. Commencing action against the corporation within a given time.
3385. Call by directors not necessary to right of action by creditor.
3386. Assessing the shareholders after insolvency.
3387. Validity of this assessment.
3388. Tender of a certificate not necessary.

§ 3374. Proving Claim before Receiver. — Upon like grounds, billholders of an insolvent bank in the hands of a receiver cannot recover of shareholders the amount for which each one is individually liable under a statute, without first proving their claim before the receiver and taking their dividend there; if they fail so to prove their claim, they can recover of the stockholders only so much as would have remained unsatisfied if they had proved their claim and received their dividends. The rule of equity that where one creditor has a claim upon two funds, and other creditors upon one of them only, the former may be compelled to charge his claim upon the fund not chargeable with the claims of the latter, so as to leave them a larger share of the common fund,[1] has no application to such a case.[2]

§ 3375. Dispenses with Necessity for Judgment even where the Statute Requires a Judgment. — Even where the statute makes the recovery of a judgment against the corporation a condition precedent to the right of the creditor

[1] Ex parte Kendall, 17 Ves. 514, 520; Dorr *v.* Shaw, 4 Johns. Ch. (N. Y.) 17.

[2] Grew *v.* Breed, 10 Met. (Mass.) 569, 579.

to proceed against the stockholder, yet where a circumstance supervenes, which renders it impossible for the creditor to prosecute his claim to judgment, this will discharge the condition and entitle him to proceed against the stockholder without a judgment against the company. This may happen where a corporation has been *dissolved* by the judgment of a court of competent jurisdiction;[1] or where it has been *adjudicated a bankrupt* under a bankruptcy law which *restrains* the prosecution of actions against it;[2] or where its assets have been impounded by a court of equity, by means of a *receiver*, for the purposes of a general winding up and distribution, especially if there is also an *injunction* against the further prosecution of judgments at law;[3] or where they have been placed in the hands of a trustee, for the benefit of the creditors, by a voluntary assignment made by the corporation under an assignment law, like that of Missouri, which allows creditors to prove their claims before the assignee; and in other possible cases that might be stated. In either of these cases it may be reasoned that the shareholder cannot be held to object to the non-performance of a condition precedent which the corporation, with which he is in privity, has, by its own act or misfortune, defeated.

§ 3376. Exhausting Deposits Made with the State.—Many of the States have adopted the policy, both as to banks and insurance companies, of requiring a deposit of securities with an officer of the State government, for the protection of bill-holders and policy-holders. Under the Indiana Statute of May 28, 1852, "to authorize and regulate the business of gen-

[1] As in Hardman *v.* Sage, 124 N. Y. 25; *s. c.* 26 N. E. Rep. 354.

[2] As in Flash *v.* Conn, 109 U. S. 371, and in Shellington *v.* Howland, 53 N. Y. 371; with which compare Handy *v.* Draper, 89 N. Y. 334; Rocky Mountain Bank *v.* Bliss, 89 N. Y. 338, and Birmingham Nat. Bank *v.* Mosser, 14 Hun (N. Y.), 605. Compare Fourth Nat. Bank *v.* Francklyn, 120 U. S. 747; Cohen *v.* New York Mutual Life Ins. Co., 50 N. Y. 610; *s. c.* 10 Am. Rep. 522; Semmes *v.* Hartford Ins. Co., 13 Wall. (U. S.) 158; Hanger *v.* Abbott, 6 Wall. (U. S.) 532; Lovett *v.* Cornwell, 6 Wend. 369; People *v.* Bartlett, 3 Hill (N. Y.), 570; Loomis *v.* Tifft, 16 Barb. (N. Y.) 541.

[3] *Post*, ch. 160; Paine *v.* Stewart, 33 Conn. 516, 531.

eral banking," and the Act of March, 1855, amendatory thereto, no suit can be maintained against a stockholder in any such bank, in his individual character, for the payment of any portion of the regular notes issued by such bank, and protested for non-payment, until it is shown that the stocks deposited with the Auditor of the State to secure the redemption of the circulation are first exhausted, or that the bank is insolvent.[1]

§ 3377. Exhausting Equitable Assets before Statutory Liability. — We have seen that the sums due by stockholders on account of their stock subscriptions are a part of the equitable assets of the corporation,—that is, in the contemplation of courts of equity, they are a part of its capital stock.[2] The individual statutory liability of stockholders is generally a superadded fund for the security of creditors. Must the creditor *exhaust the other equitable assets* of the corporation before he can proceed against this superadded fund? Must he call in what is due on account of stock subscriptions before he can proceed against the stockholder to enforce his individual statutory liability? It has been held that he need not, and it is apprehended that this will not be questioned. A judgment, an execution, and a return of *nulla bona* against the corporation furnish a sufficient foundation for a proceeding against a stockholder, under a statute making him liable for his proportionate share of the debts of the company. In such a proceeding, a plea which alleges the existence of choses in action, not subject to garnishment, in the hands of a receiver of the corporation, of equitable assets, and of an uncalled subscription for stock in the hands of stockholders, is bad on demurrer.[3] But another court has taken the view that where the stockholder is proceeded against in an action at law to enforce a statutory liability, grounded upon the fact that the corporation became *indebted in excess of its assets,* it is competent for the stockholder to show in defense that the assets of the corporation in the hands of a receiver, includ-

[1] Toucey *v.* Bowen, 1 Biss. (U. S.) 81.

[2] *Ante,* § 2952.

[3] Thornton *v.* Lane, 11 Ga. 459, 514.

ing assessments upon shares of stock not yet paid up, are sufficient to meet its obligations.[1] So, it has been held, under a statute, that the receiver of a banking corporation could not, before applying to the satisfaction of the debts of the corporation the assets in his hands, proceed to assess the several shareholders.[2] The decision appears to have been influenced by the terms of a statute, but it is thought that the rule would be the same under proper conceptions of equitable administration.

§ 3378. Exhausting Remedy against Other Judgment Debtors of Corporation. — It has been held that where the plaintiff's judgment not only runs against the corporation, but also against others impleaded with the corporation, he cannot maintain a proceeding against a stockholder to sequester what is due by him to the corporation, in respect of his unpaid subscription, without first exhausting his remedy against his judgment debtors other than the corporation.[3]

§ 3379. Not Necessary to Exhaust Individual Liability before Subjecting What is Due on Share Subscriptions. — The fact that the creditor may have a *concurrent remedy at law* against the shareholder, or against other shareholders, does not necessarily oust the jurisdiction of a court of equity to subject to the payment of his debt what may be due from the shareholder to the corporation, as so much unpaid on his share subscription. Upon this subject the Supreme Court of California have lately quoted with approval the following language of the author in a former work: "The elemental rule of equity jurisprudence that a court of this character will deny its aid to a suitor who has an adequate remedy at law, except in cases of concurrent jurisdiction, applies to this subject only so far as that these courts withhold their aid to a judgment creditor of a corporation in respect of the liability of shareholders,

[1] Stewart *v.* Lay, 45 Iowa, 604.

[2] Re Reciprocity Bank, 22 N. Y. 9, 18.

[3] Burch *v.* Taylor, 1 Wash. 245; *s. c.* 24 Pac. Rep. 438; Burch *v.* Glover, 1 Wash. 250; *s. c.* 24 Pac. Rep. 439; Burch *v.* Moore, 1 Wash. 249; *s. c.* 24 Pac. Rep. 439.

when there are legal assets of the corporation within reach of his execution. The general rule is, that although a creditor has a concurrent remedy against a shareholder at law, this does not oust the jurisdiction of the courts of equity."[1] While, therefore, the rule obtains which has been already stated, that the creditor cannot proceed against the shareholder until he has exhausted his legal remedies against the corporation, yet he can proceed against the shareholder in equity, to subject to the payment of his debt what is due from the shareholder as unpaid on his share subscription, without having proceeded to charge the shareholders in respect of their superadded statutory liability,—that is to say, to exhaust his legal remedies *against them.*[2]

§ 3380. Making Demand upon the Corporation or Its Officers.—If the liability of the stockholder is *secondary*, to be pursued only after the creditor has exhausted his remedy against the corporation, the least that could be expected of him would be to *demand* the payment of his debt of the officers of the corporation. There are also circumstances under which the creditor would not be allowed to maintain an action *against the corporation*, without making a demand previous to the commencement of the action. This, under a correct remedial system, would be the case where the creditor of a bank sues for his deposit; for, although a deposit of money in a bank is not, in a strict sense, a bailment, but creates the relation of debtor and creditor between the banker and the depositor, yet it creates this relation, subject to an understanding, implied from the custom of business or the practice

[1] Thomp. Stockh., § 265. Quoted with approval in Potter *v.* Dear, 95 Cal. 578, 581. The same principle is stated by Mr. Morawetz, where he says that a judgment creditor, after the return of his execution *nulla bona*, may maintain an action to compel the shareholders to contribute so much of the capital subscribed by them as will be sufficient to satisfy the claims of the plaintiff and other creditors who may come in for payment. Such a proceeding may be maintained, although the creditors have a statutory right to proceed against the shareholders directly at law. Morawetz Priv. Corp., 2d ed., § 866.

[2] Potter *v.* Dear, 95 Cal. 578; Baines *v.* Babcock, 95 Cal. 581; *s. c.* 29 Am. St. Rep. 158; 10 Rail. & Corp. L. J. 375; 27 Pac. Rep. 674.

of the particular bank, that the creditor will demand his money by presenting his check, his bank-book, or otherwise. A rule of procedure, which would enable him to sue the bank before his money had been demanded in the customary way would be oppressive; though it is believed that there are such rules in some of the States, under the operation of statutes dispensing with demand prior to bringing actions. But it is obvious that, whether the creditor proceeds by action against the corporation, or against the stockholder, circumstances may exist dispensing with the necessity of a demand, even where the general theory of the law would otherwise require it. The law does not require a party to do a vain thing; and if the circumstances are such that the demand could not, or obviously would not, be complied with, there is no good reason why the law should require it to be made. Thus, a general suspension by a bank, and its failure to pay its billholders generally, was held sufficient to enable a billholder to sue a stockholder without making a special demand of payment.[1] And so, where a bank had failed and closed its doors, it was held that the holder of one of its certificates of deposit might bring an action under a statute against one of its stockholders, without first going through the vain formality of making a demand upon the bank.[2]

§ 3381. What Necessary to a Good Demand. — Under a statute requiring a demand upon the corporation before bringing suit against any stockholder,[3] the demand must be personally made by some one authorized to receive payment, so that payment may be made at once, unless it is refused on grounds which dispense with a proper demand.[4] A demand *by letter* will therefore be good where the treasurer of the corporation informs the creditor that the corporation cannot pay, and fails to expose property to meet the debt.[5] In

[1] Lane *v.* Morris, 8 Ga. 468.

[2] Hodgson *v.* Cheever, 8 Mo. App. 318.

[3] Rev. Stat. N. Y. 1842, ch. 146, § 3. See, also, Gen. Stat. N. H. 1867, ch. 136, §§ 1, 2, 3.

[4] Haynes *v.* Brown, 36 N. H. 545. Compare Phelps *v.* Gilchrist, 28 N. H. 266.

[5] Connecticut River Sav. Bank *v.* Fiske, 60 N. H. 363.

another decision the same court has stated more explicitly that such a demand should be a request for the immediate payment of a liability fully due; made personally by the creditor or his authorized agent, holding and exhibiting, or stating specifically, the character and amount of such liability; upon some agent of the corporation shown by evidence, or by law and usage entitled, and so presumed to hold the funds of the corporation for the purpose of paying, and whose duty it is to pay, such liability; at his office, or other usual place of business, during business hours of the day of the demand; or upon some agent of the corporation, whose duty it is to see that the debts of the corporation are duly paid, and that means are seasonably provided for and applied to that purpose, or that a meeting of the stockholders is called to provide such means.[1] If we may accept the analogy applicable in cases of a demand by a landlord for *rent*, it will be enough if both parties understand that a demand is made;[2] but it has been held that the most formal demand, drawn up by the attorneys of the creditors, and left with the officers of the corporation by a *messenger* not authorized to receive payment at the time, does not comply with such a statute.[3] As to the *place* where the demand should be made, it has been held,—under a statute of Massachusetts requiring a demand, in the county in which the corporation had its usual place of business, on an execution against the corporation,—that evidence of meetings, and the keeping of the official records and books, and of printed headings of the corporation, giving the address of the treasurer in that county, is sufficient to warrant a finding that the corporation has a usual place of business there.[4]

§ 3382. Notifying Stockholder of Proceeding against Corporation. — Where the view, spoken of elsewhere,[5] that a

[1] Harvey *v.* Chase, 38 N. H. 272.

[2] Norris *v.* Morrill, 40 N. H. 395, 401. For a letter from a stockholder to the treasurer of the company, which showed that a demand had been made upon the stockholder for an *assessment*, see Ossipee &c. Man. Co. *v.* Canney, 54 N. H. 295; and as to demands for assessments, see *ante*, §§ 1747, 2931.

[3] Haynes *v.* Brown, 36 N. H. 545, 564.

[4] First Nat. Bank *v.* Hingham Man. Co., 127 Mass. 563.

[5] *Ante*, § 3349.

summary remedy will lie against the stockholder without notice and without violating any constitutional right, was taken, a proceeding which subjected the body and estate of a casual shareholder in a corporation to execution for the satisfaction of a corporate debt, without notice of the suit against the corporation and an opportunity to contest the question of his liability, fell into disfavor in Massachusetts, with the growth of manufactories and the consequent multiplication of corporations. Accordingly, we meet with a statute in that State reading: "The person or property of any stockholder in a manufacturing corporation shall not be hereafter taken upon any execution issued against the corporation, unless the summons in the action was left with said stockholder."[1] This statute did not require any change in the writ or declaration from the form previously in use in suits against corporations. It did not enable a stockholder to contest the liability, even where the corporation allowed a judgment to go against it by default. The statute simply gave the stockholder so summoned the right to appear and be heard upon the question of his being a member of the corporation, instead of driving him to test the question in an action of trespass against an officer who had levied on his body or goods under the former statute.[2] But stockholders summoned under this statute are entitled to set up a defense, the substance of which is that the real plaintiff is another stockholder, and therefore disabled from suing.[3] They may show that the plaintiff took the note sued on when overdue, and without consideration, and that he holds it for the sole use and benefit of the payee, who is a stockholder in the corporation, and equally liable on it with themselves.[4] The liability of a stockholder, not summoned to appear in conformity with this statute, is extinguished by the judgment

[1] Stat. Mass. 1851, ch. 315, § 1.

[2] Holyoke Bank *v.* Goodman Paper Man. Co., 7 Cush. (Mass.) 576; Farnum *v.* Ballard Vale Machine Shop, 12 Cush. (Mass.) 507; Robbins *v.* Justices, 12 Gray (Mass.), 225. Several stockholders separately summoned, severally denying their liability, were not entitled to separate juries. *Ibid.*

[3] Compare *ante*, § 3125.

[4] Thayer *v.* Union Tool Co., 4 Gray (Mass.), 75.

against the corporation, in which the original cause of action becomes *merged*. This was held, however, in a case where the stockholder had ceased to be such a year before the rendition of the judgment against the corporation.[1] Nor is the liability of a person as a stockholder established merely by proof that he was summoned in the suit in which judgment was rendered against the corporation, and failed to appear.[2]

§ 3383. **Giving Notice to the Stockholder of the Default of the Corporation.** — Under a statute of Maine, providing, in substance, that where, after demand of payment by the creditor upon the corporation, the latter should, for the period of sixty days, fail to pay the debt or to expose property from which the creditor could procure its satisfaction, he should have a right of action against its stockholders, — it is held necessary, under the general principles of law, for the creditor, before he can bring his action against a stockholder, to notify the stockholder of the default of the corporation.[3] The court likened the position of the stockholder to that of a guarantor, who, under well-settled principles, is entitled to notice of the default of the principal whose debt he has guaranteed.[4] But under a statute of Maine, similar to earlier statutes of Massachusetts allowing creditors of corporations to have execution against their stockholders in certain cases, it has been held that where an officer, having an execution against a corporation, has given a stockholder a notice of his intention to levy on his individual property, unless the stockholder points out to him corporate property sufficient to satisfy his debt, — it is not necessary for the creditor or the levying

[1] Handraham *v.* Cheshire Iron Works, 4 Allen (Mass.), 396; Mason *v.* Cheshire Iron Works, 4 Allen (Mass.), 398.

[2] Mason *v.* Cheshire Iron Works, 4 Allen (Mass.), 398.

[3] Hicks *v.* Burns, 38 N. H. 141.

[4] Norton *v.* Eastman, 4 Me. 521, 525; Howe *v.* Nickels, 22 Me. 175; Babcock *v.* Bryant, 12 Pick. (Mass.) 133, 135; Mussey *v.* Rayner, 22 Pick. (Mass.) 223; Sturges *v.* Robbins, 7 Mass. 301; Dyer *v.* Rich, 1 Met. (Mass.) 180; Lent *v.* Padelford, 10 Mass. 230; *s. c.* 6 Am. Dec. 119; Safford *v.* Stevens, 2 Wend. (N. Y.) 158; Rapelye *v.* Bailey, 3 Conn. 438; *s. c.* 8 Am. Dec. 199; Dix *v.* Flanders, 1 N. H. 246; Watson *v.* Walker, 23 N. H. 471; Whitton *v.* Whitton, 38 N. H. 127; *s. c.* 75 Am. Dec. 163.

officer to give a further and distinct notice of an intention to commence an action against the stockholder before it can be instituted.[1]

§ **3384. Commencing Action against the Corporation within a Given Time.**—There are statutes, in the nature of statutes of limitation, and hence more fully considered under that head,[2] which impose, as a condition precedent to the right of a creditor to pursue a stockholder, that he shall have commenced suit against the corporation within a certain time after the contracting of the debt,—generally one year.[3] Such a statute is not complied with by the commencement of a suit for a *part* of the debt. Accordingly, where a creditor brought an action against a corporation, before a justice of the peace, upon an account for work and labor, etc., amounting to $366.60, the complaint claiming $200 only (that being the extent of the justice's jurisdiction), and no suit had been brought against the company for the balance of the account, it was held, in an action by a creditor against a stockholder, that the recovery must be limited to $200 and interest.[4]

§ **3385. Call by Directors not Necessary to Right of Action by Creditor.**— Where subscriptions are payable upon call, the creditor need not, as a prerequisite to his right of action, have tried to induce the corporation to make a call.[5] Whilst, as already seen, the corporation cannot maintain an action against the stockholder under most of the contracts of subscription, without first making a call and giving him notice thereof,[6] yet, when the corporation becomes insolvent, it is not necessary to let in the right of the creditor to proceed against the stockholder, or against his estate, that the call should have been made;[7] but in a winding-up proceeding in

[1] Ingalls *v.* Cole, 47 Me. 530.

[2] *Post*, § 3768.

[3] Laws N. Y. 1848, ch. 40, § 24; 2 Rev. Stat. N. Y., 5th ed., 663, § 47.

[4] Shellington *v.* Howland, 67 Barb. (N. Y.) 14; *s. c.* affirmed in 53 N. Y. 371.

[5] Thompson *v.* Reno Sav. Bank, 19 Nev. 171; *s. c.* 3 Am. St. Rep. 881.

[6] *Ante*, §§ 1702, 1747.

[7] Where the subscriber makes an assignment for the benefit of *his* creditors, and the corporation becomes insolvent, a creditor of the latter may

equity, bankruptcy, or under a voluntary assignment for creditors, the court, or other statutory officer, will make the necessary call.[1]

§ 3386. Assessing the Shareholders after Insolvency.— As already seen, when a corporation becomes dissolved, either *de jure* or *de facto*, and a court of equity lays hold of its assets for the purpose of administering them as a trust fund for its creditors, the necessity of an assessment by the directors ceases; but the court itself will make the assessment after ascertaining what assessment is necessary to liquidate its debts and pay the costs of the winding-up proceeding.[2] This assessment must be made *by the court* or by some *officer authorized by statute* to make it. For instance, in the winding up of a national bank it is ordered by the Comptroller of the Currency, under a provision of the National Currency Act.[3] In the absence of a statute authorizing a receiver to make it, it cannot be made by him; but it is for the court to determine the amount of the indebtedness of the corporation, and to fix the percentage which will be assessed against each share.[4] To this end it is necessary, according to the ordinary practice of chancery, that an *account* should be taken of the assets and debts of the corporation, of the aggregate amount unpaid by the stockholders or otherwise assessable against them, and of the amount unpaid or otherwise assessable against each particular stockholder, in order that a just and ratable assessment may be made upon them; and this necessarily requires a proceeding *in equity*, or, under the codes, a proceeding of that nature.[5] Until such an account has been taken, and an order of the court made, in the nature of a call upon the stockholders, the receiver cannot

enforce his claim against the estate of the subscriber, though no calls on the subscription had been made at the time of the assignment. Samainego *v.* Stiles (Ariz.), 20 Pac. Rep. 607.

[1] *Post*, § 3537.

[2] Hawkins *v.* Glenn, 131 U. S. 319; *ante*, § 2961; *post*, § 3537.

[3] Kennedy *v.* Gibson, 8 Wall. (U. S.) 498, 505; *dictum* in Sanger *v.* Upton, 91 U. S. 56, 59.

[4] Chandler *v.* Keith, 42 Iowa, 99.

[5] Mann *v.* Pentz, 3 N. Y. 415, 423.

maintain an action against them;[1] and the same rule is applicable where the assets of the insolvent corporation are being administered by an *assignee* under a State insolvent law.[2] In such a case the rule, after careful consideration, has been said to be this: That where the total amount which is due and payable from all the stockholders is not more than sufficient to pay the debts of the corporation, no previous assessment, either by the directors or by a court of equity, is necessary as a prerequisite to the bringing of an action at law by the assignee of the corporation against a stockholder for his unpaid balance. But where the total amount due by the stockholders will, if collected, be much more than sufficient to pay the corporate debts, either an assessment by the directors of the necessary amount, or an order of a court of equity as a substitute for such assessment, is necessary as a preliminary to the right to sue at law.[3]

§ 3387. **Validity of this Assessment.** — This assessment, in order to be valid, must be *equal and ratable.* This, as already seen,[4] is the rule where the corporation itself makes the assessment, and sues to enforce it while it is a going concern; and on parallel grounds of justice it must be the same where a court of equity makes the assessment for the purpose of raising funds to liquidate the debts of the corporation. Moreover, on the plainest principles of justice, the stockholder ought here, as where the assessment is made by the directors, to have *notice* of it before being sued for not paying it, — though, on principles of convenience, the notice may be, and often is, given by some form of *publication*, and not by direct personal notification.[5] To this principle there are exceptions in Pennsylvania[6] and some other States; but

[1] Mann *v.* Pentz, 3 N. Y. 415, 423; Chandler *v.* Keith, *supra.*

[2] Boeppler *v.* Menown, 17 Mo. App. 447.

[3] *Ibid.* To the same effect, see Citizens' &c. Sav. Bank *v.* Gillespie, 115 Pa. St. 564; *s. c.* 9 Atl. Rep. 73; 7 Cent. Rep. 523.

[4] *Ante*, § 1721; also *post*, § 3539.

[5] *Ante*, § 1756.

[6] *Ante*, §§ 1749, 1750; Spellier Electric Time Co. *v.* Geiger, 147 Pa. St. 399; *s. c.* 23 Atl. Rep. 547.

they are ill-founded, unjust, and oppressive.[1] Moreover, the shares cannot be assessed, even for the benefit of creditors, in plain violation of the contract of subscription. But, as already seen,[2] there is a strong tendency on the part of the courts, proceeding on general principles of justice, to discharge conditions in contracts of subscription for shares in regard of the assessability of the subscriber, where it is necessary to do so in order to liquidate the debts of the corporation after its insolvency. And even while the company continues to be a going concern, there is a tendency to construe conditions restricting the power of the company to assess the shares, as *conditions subsequent*, and not as conditions precedent; since to construe them as conditions precedent might prevent the company from raising the money to prosecute its enterprise, and thus defeat the purpose of its existence.[3] Thus, we find a holding to the effect that stipulations in a contract of subscription for the shares of a railway company, that certain percentages of the subscription should be paid at certain stages in the progress of the work, are not to be regarded as conditions precedent, for the reason that so to hold might prevent the company from raising the money to complete the work to such stages, and so defeat the object of the incorporation.[4]

§ 3388. Tender of a Certificate not Necessary. — We have already seen[5] that the issuing of a share certificate to a subscriber for shares is not at all necessary to make him a shareholder, the certificate being merely a supplementary *evidence*

[1] Questions are constantly being suggested by recent decisions concerning the validity of assessments against shareholders, both by the directors while the company is a going concern, and by the courts in a winding-up proceeding after insolvency. It has been ruled that it is not a good defense to an assessment to raise money to pay a corporate debt that the debt was *ultra vires*, unless it was *ultra vires* in such a sense that the corporation could defend against its payment on that ground. Taylor *v.* North Star Gold Mining Co., 79 Cal. 285; *s. c.* 21 Pac. Rep. 753. See *ante*, § 3115.

[2] *Ante*, § 3385, *et seq.*

[3] *Ante*, § 1342, *et seq.*

[4] McGinnis *v.* Kortkamp, 24 Mo. App. 378.

[5] *Ante*, § 1140.

of his title, and that in an action by the corporation against him for assessments in respect of his shares it is no defense on his part that no certificate has been issued to him.[1] It must occur to every one, and for reasons at least as strong, that the issuing or tendering of a share certificate to a shareholder is not a condition precedent to the right to maintain an action against him, whatever be its form, by or on behalf of a creditor or creditors of the corporation for debts due by the corporation.

[1] *Ante*, § 1962; Astoria &c. R. Co. *v.* Hill, 20 Or. 177; *s. c.* 25 Pac. Rep. 379.

CHAPTER LX.

EFFECT OF JUDGMENT AGAINST THE CORPORATION.

SECTION
3392. Judgment against corporation conclusive.
3393. Theory and extent of this doctrine.
3394. Application of the rule.
3395. Theory of this rule: privity of stockholder with the corporation.
3396. Conflicting decisions in New York.
3397. New York rule different in respect of liability for unpaid shares: judgment *prima facie* evidence against stockholder.
3398. Where the action is against trustees to enforce a personal liability for failing to file reports.
3399. Doctrine that a judgment against the corporation is *prima facie* evidence of the debt in a proceeding against the stockholder.
3400. Subject to be impeached for collusion or fraud.
3401. Conclusiveness of judgments by default.

SECTION
3402. Going behind the judgment where the stockholder is liable only for a particular class of debts.
3403. Judgment against corporation after dissolution not evidence to charge stockholder.
3404. Decree assessing shareholders in winding-up proceedings conclusive without personal service.
3405. Whether suit against stockholder is upon judgment or original demand.
3406. Right of stockholder to appeal or prosecute error from judgment against corporation.
3407. Recitals in judgment against corporation not evidence against stockholder.
3408. Judgment against stockholders in actions against the corporation.
3409. Conclusiveness of judgment in supplementary proceeding against stockholder.

§ 3392. Judgment against Corporation Conclusive.— Whilst, as hereafter seen,[1] the stockholder is denied the privilege of appearing and contesting the merits of a suit against the corporation, although he may be ultimately liable in respect of the judgment therein rendered, yet when a judgment is rendered against the corporation, it establishes, as conclusively

[1] *Post,* §§ 3504, 4476, *et seq.*

as any judgment can establish, the matter in litigation, the liability of the corporation to pay the debt. Like any other judgment, it may be impeached for fraud, or for want of jurisdiction, by a party entitled to question it, but it cannot be assailed collaterally by a stockholder for any other cause, when sought to be charged in respect of it. It is valid until reversed in a direct proceeding, and concludes the stockholder, who is in privity with the corporation.[1]

§ **3393. Theory and Extent of This Doctrine.**— All the foregoing cases imply that the stockholder is in privity with the corporation — a part of it, so to speak — and bound by the judgment against it by representation. They proceed upon the view that it is quite unnecessary to the conclusiveness of the judgment as established, for the purpose of charging him with the indebtedness of the corporation, that he have had *notice* and an opportunity to defend in that action: the law is,

[1] Merrill *v.* Suffolk Bank, 31 Me. 57; *s. c.* 50 Am. Dec. 649; Came *v.* Brigham, 39 Me. 35; Milliken *v.* Whitehouse, 49 Me. 527, 529; Slee *v.* Bloom, 20 Johns. (N. Y.) 669; Moss *v.* Oakley, 2 Hill (N. Y.), 265; Belmont *v.* Coleman, 1 Bosw. (N. Y.) 188; Donworth *v.* Coolbaugh, 5 Iowa, 300; Wilson *v.* Pittsburgh &c. Coal Co., 43 Pa. St. 424; Grund *v.* Tucker, 5 Kan. 70; Gaskill *v.* Dudley, 6 Met. (Mass.) 546; *s. c.* 39 Am. Dec. 750; Miller *v.* White, 57 Barb. (N. Y.) 504; 8 Abb. Pr. (N. S.) (N. Y.) 46; Thayer *v.* New England &c. Co., 108 Mass. 523; Conklin *v.* Furman, 8 Abb. Pr. (N. S.) (N. Y.) 161; Corse *v.* Sanford, 14 Iowa, 235; Stutz *v.* Handley, 7 Rail. & Corp. L. J. 407; *s. c.* 41 Fed. Rep. 531; Howard *v.* Glenn, 85 Ga. 238; *s. c.* 21 Am. St. Rep. 156; 11 S. E. Rep. 610; Glenn *v.* Liggett, 135 U. S. 533; *s. c.* 8 Rail. & Corp. L. J. 52; 10 Sup. Ct. Rep. 867; Baines *v.* Story, 80 Pac. Rep. 777; Heggie *v.* People's Building &c. Asso., 107 N. C. 581; 9 Rail. & Corp. L. J. 71; 32 Am. & Eng. Corp. Cas. 605; 12 S. E. Rep. 275 (in principle); Barron *v.* Paine, 83 Me. 312; *s. c.* 22 Atl. Rep. 218; Peddell *v.* Gwyn, 1 Hurl. & N. 590; Bradley *v.* Eyre, 11 Mees. & W. 432; Fowler *v.* Rickerby, 2 Man. & Gr. 760; Chicago &c. Bridge Co. *v.* Anglo-American Packing &c. Co., 46 Fed. Rep. 584; Cleveland Rail. Mill Co. *v.* Crawford, 9 Rail. & Corp. L. J. 171. *Contra*, Moss *v.* McCullough, 5 Hill (N. Y.), 131; Strong *v.* Wheaton, 38 Barb. (N. Y.) 616; Miller *v.* White, 50 N. Y. 137; McMahon *v.* Macy, 51 N. Y. 155. See Moss *v.* Averell, 10 N. Y. 449; Belmont *v.* Coleman, 21 N. Y. 96; *s. c.* 1 Bosw. (N. Y.) 188; Hampson *v.* Weare, 4 Iowa, 13; *s. c.* 66 Am. Dec. 116. And *post*, §§ 3397, 3399; Lawyer *v.* Rosebrook, 48 Hun (N. Y.), 453; *s. c.* 16 N. Y. St. Rep. 316; Baines *v.* Babcock, 95 Cal. 581; *s. c.* 29 Am. St. Rep. 158; 30 Pac. Rep. 776.

that he is bound without other notice than that which he has had by representation through the corporation.[1] One court has gone further, and held that the judgment against the corporation is ordinarily conclusive evidence, not only of the fact that the corporation was debtor to the plaintiff in the amount of the recovery, but also of the fact of the *existence of the corporation;* and that such a judgment, whether given in an action *ex contractu* or *ex delicto,* is an indebtedness of the corporation, for which a stockholder is liable to the amount due on his stock.[2] Somewhat in line with this is a case in Missouri, where the court held that, for the purposes of a motion for an execution against a stockholder under a statute of that State, a *judgment* against the company is *presumptive evidence* of its corporate existence at the time the judgment was rendered, and hence, that if the stockholder would resist his liability, as such, on the ground of irregularity or defect in the organization of the company, he must *make proof* of such irregularity or defect.[3] The propriety of the rule that the recovery by the creditor of a judgment against the corporation conclusively establishes his *debt* for the purpose of charging the shareholder, in the absence of fraud or collusion, is seen when we recur to the correlative rule that a judgment, execution, and return of *nulla bona* are the evidence which the law in general *requires* of the fact of the creditor having exhausted his remedies against the corporation, before allowing him to proceed against the shareholder, which often affords conclusive proof of that fact.[4]

[1] Glenn *v.* Springs, 26 Fed. Rep. 494; Powell *v.* Oregonian R. Co., 3 L. R. A. 201; *s. c.* 6 Rail. & Corp. L. J. 28; 38 Fed. Rep. 187; Mason *v.* Force, 30 Ga. 99.

[2] Powell *v.* Oregonian R. Co., *supra.*

[3] Schaeffer *v.* Missouri &c. Ins. Co., 46 Mo. 248.

[4] *Ante,* §§ 3357, 3363. The analogous rule in regard to the liability of the *inhabitants* of *New England towns,* involving the theory that they are, in a sense, *parties* to actions against the town, and bound by the judgment against it, and liable to execution under that judgment, — points to the possible origin of the rule, as established in America. See and compare Gaskill *v.* Dudley, 6 Met. (Mass.) 546; *s. c.* 39 Am. Dec. 750; Thayer *v.* New England Lithographic Co., 108 Mass. 528; Brewer *v.* New Gloucester, 14 Mass. 216; Sutton *v.* Cole, 8 Mass.

§ 3394. Application of the Rule. — Thus, the mere fact that the account annexed to the declaration bore date three days before the corporation first elected its officers, and consequently before it was in existence as a corporation, was not sufficient to rebut the evidence of liability afforded by the judgment itself.[1] Neither could a stockholder, when sued on a judgment obtained by default against the corporation, dispute that the person who signed, as *treasurer* of the corporation, the note on which such judgment was obtained, was in fact the treasurer, — the evidence showing that he acted as such.[2] Nor would he be heard to show that the indebtedness for which the judgment was rendered against the company was a liability of the president of the company, and not of the company itself.[3]

§ 3395. Theory of This Rule: Privity of Stockholder With the Corporation. — The theory of this rule is, that the stockholder is so far an integral part of the corporation as to be privy to the proceedings against it, and bound by representation.[4] "The corporation," says Davis, J., "represents the share-owners in defending actions involving the rights and obligations of the corporation, and, in the absence of fraud or collusion, binds them; and individual stockholders cannot assert or defend the rights of the corporation."[5] The rule does not rest upon the *presumption of notice* as much as upon the theory that the stockholder, by joining an artificial body, which may be impleaded in its artificial name, has impliedly agreed to be bound by any judgment recovered against it in a case before any court of competent jurisdiction, in which it has been so impleaded. As elsewhere seen,[6] it is by no means a universal principle that notice to the corporation is notice

96; Odiorne *v.* Wade, 8 Pick. (Mass.) 518; Lufkin *v.* Haskell, 3 Pick. (Mass.) 356; Merchants' Bank *v.* Cook, 4 Pick. (Mass.) 405.

[1] Hawes *v.* Anglo-Saxon Co., 101 Mass. 385, 397.

[2] Milliken *v.* Whitehouse, 49 Me. 572.

[3] Donworth *v.* Coolbaugh, 5 Iowa, 300.

[4] Hawkins *v.* Glenn, 131 U. S. 319; Lewis *v.* Glenn, 84 Va. 947; *s. c.* 6 S. E. Rep. 866; Glenn *v.* Liggett, 135 U. S. 533; Sanger *v.* Upton, 91 U. S. 56, 58; Glenn *v.* Williams, 60 Md. 93, 116; Hamilton *v.* Glenn, 85 Va. 901; *s. c.* 19 S. E. Rep. 129; *post*, § 3499.

[5] Heggie *v.* People's Building Asso., 107 N. C. 581, 590. The well-known *exception* to this *rule* will be considered in a future title: *Post*, § 3504.

[6] *Ante*, § 1081; *post*, § 5234.

to the stockholder; and yet there are cases in which, according to judicial holdings, the stockholders of a corporation are charged with the knowledge of the facts disclosed by the corporate records, and by the public statutes of the State relating to a mortgage of the corporate assets; and where such means of knowledge are open to a stockholder, and he does not avail himself of them, the principle[1] applies to him that negligent or willful ignorance carries with it, in equity, the same consequences as actual knowledge.[2]

§ 3396. Conflicting Decisions in New York.—Decisions in the State of New York on this question leave the subject in a very unsatisfactory condition, so far as they relate to the original liability of the stockholder as a *partner*, which, as already seen,[3] is the liability *imposed* (or rather *left*) on the stockholders of various corporations by statutes in that State. In respect of this species of liability, the last decision in that State which has fallen under the writer's notice was pronounced by the late Commission of Appeals. It presents a conflict of opinion among the members of the commission, four of them holding that, in an action to charge stockholders for the debts of the corporation, a judgment against the corporation is neither conclusive nor *prima facie* evidence of the existence of the debt against the company, and three of them dissenting.[4] Contemporaneously with this decision of the Commission of Appeals, the Court of Appeals held that in an action to charge the *trustees* of a manufacturing corporation, under a statute, with a debt of the corporation, for failing to file and publish an annual report, proof of the recovery of a judgment against the corporation for the debt was

[1] See Le Neve *v.* Le Neve, 2 Lead. Cas. Eq. 21; Stephenson *v.* Smith, 7 Mo. 610, 617.

[2] Kitchen *v.* St. Louis &c. R. Co., 69 Mo. 224, 265.

[3] *Ante*, § 3072, *et seq.*

[4] McMahon *v.* Macy, 51 N. Y. 155, 162, where the cases are reviewed by Gray, Com. See, also, Moss *v.* McCullough, 5 Hill (N. Y.), 131; Wheeler *v.* Miller, 24 Hun (N. Y.), 541; Lawyer *v.* Rosebrook, 48 Hun (N. Y.), 453; Conant *v.* Van Shaick, 24 Barb. (N. Y.) 87. Compare Atcherson *v.* Troy &c. R. Co., 6 Abb. Pr. (N. S.) (N. Y.) 329; *s. c.* 1 Abb. App. Dec. 13; Slee *v.* Bloom, 20 Johns. (N. Y.) 669, 684; Moss *v.* Oakley, 2 Hill (N. Y.), 265, 267; Moss *v.* McCullough (2d appeal), 7 Barb. (N. Y.) 279, 296; Belmont *v.* Coleman, 21 N. Y. 96; Strong *v.* Wheaton, 38 Barb. (N. Y.) 616, 621; Jackson *v.* Griswold, 4 Hill (N. Y.), 522, 529.

neither conclusive nor *prima facie* evidence of its validity.[1] But as it is the duty of the trustees to defend the action for the corporation, the common sense of the rule which requires the creditor to establish his debt a second time, in order to charge the trustees personally, does not strikingly appear.[2] Under the present rule in New York, it has been held that to entitle a person suing for a debt due for work and labor to recover, he must prove, not only the existence of the corporation, the recovery of a judgment against it, the issuing and return of an execution unsatisfied, in whole or in part, but also the performance of labor to some amount, and that the defendants are stockholders.[3]

§ 3397. New York Rule Different in Respect of Liability for Unpaid Shares: Judgment Prima Facie Evidence against Stockholder.—Distinguishing the cases cited in the two preceding sections on the ground that the liability declared by the statutes there under consideration was *penal*,[4] the Court of Appeals of New York hold that where the proceeding is brought by a judgment creditor of a corporation to reach assets of the corporation which have been divided among the stockholders, the judgment against the corporation is at least *prima facie* evidence of the liability of the stockholder.[5] In a subsequent case in the same court, where the proceeding was to charge a stockholder of a *railway company* with the *double liability* imposed by the statute of that State,[6] the court upheld the same principle so far as to hold that the judgment against the corporation was *competent evidence* of the *status* of the plaintiff as a creditor of the company and of the amount due him; but the court did not hold that it was *conclusive evidence.*[7]

§ 3398. Where the Action is against Trustees to Enforce a Personal Liability for Failing to File Reports. — Upholding

[1] Laws N. Y. 1848, p. 57, § 12; 2 Rev. Stat., 5th ed., 661, § 35.

[2] Miller *v.* White, 50 N. Y. 137, reversing *s. c.* 10 Abb. Pr. (N. S.) (N. Y.) 385; 59 Barb. (N. Y.) 434. Compare Jones *v.* Barlow, 62 N. Y. 202, 207.

[3] Strong *v.* Wheaton, 38 Barb. (N. Y.) 616.

[4] See *ante*, § 3018.

[5] Hastings *v.* Drew, 76 N. Y. 9.

[6] N. Y. Laws 1850, ch. 240, as amended by *Id.* 1854, ch. 282.

[7] Stephens *v.* Fox, 83 N. Y. 313; affirming *s. c.* 17 Hun (N. Y.), 435. Compare Grand Rapids Sav. Bank *v.* Warren, 52 Mich. 561; Chase *v.* Curtis, 113 U. S. 452, 458; and Flash *v.* Conn, 109 U. S. 371.

the untenable distinction between penal and remedial statutes, the Supreme Court of the United States applied the same principle in a case where it was sought to charge the *trustees* of a manufacturing company, under the statute of New York,[1] with a personal liability for *failing to file reports* of the capital and debts of the company. The court held, on the authority of many decisions of the Court of Appeals of New York, that the statute is *penal* in its character, and must be construed with great strictness against those who are sought to be subjected to its liabilities,[2] and they concluded that the fact upon which the liability depends must be strictly proved; consequently that the judgment against the corporation is not even *prima facie* evidence of the debt as against the defendants.[3] This decision is quite in conformity with the holdings of the Court of Appeals of New York in the cases already cited,[4] and with the *dictum* of the same court in a celebrated case where the proceeding was to enforce the same species of liability: "The debt must be proved by evidence *competent against the defendants.* The facts upon which the debt is founded must be proved. The naked admissions of the corporation, or judgment against the corporation, are not evidence against the trustees. They are *res inter alios acta;* but when facts are proved which would establish the existence of a debt against the corporation, the liability of the trustees for the debt follows upon the proof of the other facts upon which the liability is made by statute to depend."[5] But there is no sense in the rule which makes the *stockholders* liable, in a proceeding to enforce

[1] N. Y. Act of Feb. 17, 1848, § 12, as amended by Act of June 7, 1875.

[2] Citing Merchants' Bank *v.* Bliss, 35 N. Y. 412; Wiles *v.* Suydam, 64 N. Y. 173; Easterly *v.* Barber, 65 N. Y. 252; Knox *v.* Baldwin, 80 N. Y. 610; Veeder *v.* Baker, 83 N. Y. 156; Pier *v.* George, 86 N. Y. 613; Stokes *v.* Stickney, 96 N. Y. 323; Bruce *v.* Platt, 80 N. Y. 379; Garrison *v.* Howe, 17 N. Y. 458; Miller *v.* White, 50 N. Y. 137; Whitney Arms Co. *v.* Barlow, 63 N. Y. 62; *s. c.* 20 Am. Rep. 504. Other cases on the same rule of construction are: Steam-Engine Co. *v.* Hubbard, 101 U. S. 188; Flash *v.* Conn, 109 U. S. 371.

[3] Chase *v.* Curtis, 113 U. S. 452.

[4] *Supra*, note 2. Compare *post*, §§ 4164, 4165.

[5] Whitney Arms Co. *v.* Barlow, 63 N. Y. 62, 72; *s. c.* 20 Am. Rep. 504, *per* Allen, J.

against them a superadded double liability for the debts of the corporation, previous to a judgment obtained against it,[1] and which exonerates the *trustees* from the operation of the same rule in a proceeding to enforce an individual liability against them. Nor should the fact that their liability grows out of their failure or refusal to obey a provision of the statute law of the State, founded in public policy, place them in a better position than the stockholders who are not guilty of any personal wrong. Such decisions involve an impudent assumption on the part of the judicial courts of a power to repeal useful and beneficial public statutes, by refusing to execute them. Moreover, the stockholders are often scattered, living in other States and even in foreign countries. In many cases they never know what actions are being prosecuted against the corporation in the different jurisdictions in which service of process can be obtained against it. On the contrary, the trustees are, for practical purposes, the corporation itself. They are its managers. It is their duty to defend actions which are brought against it on unfounded demands, and a failure to perform this duty is a breach of their trust. When, therefore, a judgment is obtained against the corporation, it is, in substance and in sense, obtained against them; and consequently, in a subsequent proceeding to charge them personally for the debt thereby established, there is no sense — none whatever — in compelling the judgment creditor to prove his demand a second time. Such decisions are mere judicial fetish.

§ 3399. Doctrine that a Judgment against the Corporation is Prima Facie Evidence of the Debt in a Proceeding against the Stockholder. — This brings us to the consideration of a large number of holdings, chiefly in New York, to the effect that, in an action against a stockholder individually liable for the debts of a corporation, for the recovery of a debt contracted by the company, a judgment previously recovered against the corporation on the same demand is *prima facie* evi-

[1] Rule of the preceding and of the next section.

dence of a debt against the defendant, subject to be impeached for collusion or mistake.[1] What these holdings mean in using the expression "*prima facie evidence*" is not very clear. In one of them it is said that the judgment is subject to be impeached for collusion or mistake.[2] Another of them holds that the judgment is *competent evidence* against the stockholder of the *status* of the plaintiff as a creditor of the corporation, and of the amount due him;[3] but this does not explain to what extent impeaching evidence will be let in. In the case last cited, Rapallo, J., says: "A judgment against the corporation, being the highest evidence against it, should be as effectual to pass its title to the fund in question as a deed or any other form of transfer."[4] Another case is to the effect that the judgment is *prima facie evidence* of the debt against the stockholder, except in the case of fraud or collusion.[5] But this allows the same conclusiveness which attends every judgment, and no more; for every judgment may be impeached in equity for fraud or collusion in its concoction. In another case, in one of the subordinate courts of New York, it is reasoned that the stockholder may question the judgment in any way, or upon any ground showing *illegality* or *error*.[6] In another case in such a court a judgment had been rendered against a corporation as the acceptor of a draft, execution had been issued thereon and returned *nulla bona*, and proceedings were instituted to enforce satisfaction from a stockholder. The court held that the *judgment* was *prima facie evidence* that the draft was properly drawn and accepted by a duly authorized officer of the company.[7] It would seem from these citations

[1] Moss *v.* Averell, 10 N. Y. 449; Moss *v.* McCullough, 7 Barb. (N. Y.) 279; Belmont *v.* Coleman, 21 N. Y. 96; affirming *s. c.* 1 Bosw. (N. Y.) 188; Houghland *v.* Bell, 36 Barb. (N. Y.) 57; Corse *v.* Sanford, 14 Iowa, 235; Squires *v.* Brown, 22 How. Pr. (N. Y.) 35; Grund *v.* Tucker, 5 Kan. 70; Hastings *v.* Drew, 76 N. Y. 9; Schaeffer *v.* Missouri &c. Ins. Co., 46 Mo. 248.

[2] Moss *v.* Averell, 10 N. Y. 449.

[3] Stephens *v.* Fox, 83 N. Y. 313; affirming *s. c.* 17 Hun (N. Y.), 435.

[4] *Ibid.*

[5] Moss *v.* McCullough, 7 Barb. (N. Y.) 279.

[6] Belmont *v.* Coleman, 1 Bosw. (N. Y.) 188.

[7] Hoagland *v.* Bell, 36 Barb. (N. Y.) 57.

that the New York courts use the expression, "*prima facie evidence*," in a very inartificial sense. *Prima facie evidence* is understood to be such evidence as, *if believed* by the trier or triers of the fact, entitles the party producing it to a verdict and judgment, unless it is overcome by countervailing evidence. This is the sense in which the judges use it in actions for damages for negligence, and in many other cases. It would seem that, in the theory of most of the above cases, the judgment against the corporation is *conclusive* against the stockholder, unless it is impeached by him for collusion or fraud.

§ **3400. Subject to be Impeached for Collusion or Fraud.** — All judgments are subject to be impeached in equity, by a direct proceeding to that end, where they have been procured by fraud or collusion. "A judgment obtained by fraud or collusion," says Sir Nathaniel Lindley, "is always impeachable by innocent parties affected by it; and however high the tribunal in which the judgment has been pronounced may be, its invalidity on the ground of fraud may be examined by any inferior court which may happen to be called upon to give effect to it."[1] "If, therefore," the learned author continues, "a shareholder is proceeded against upon a judgment obtained by fraud on the part of the creditor, the judgment may be impeached; and it seems that the shareholder may at his option either apply to the court in which the judgment was obtained to have it set aside, or rely on the fraud as a defense to a *scire facias*, or to an application for leave to issue execution as the case may be."[2] Under the modern American codes of procedure where *equitable defenses* are allowed in actions at law, no reason is

[1] Lind. Comp. Law, 5th ed., 283; citing Shedden *v.* Patrick, 1 Macq. H. L. (Sc.) 535; Duchess of Kingston's case, 3 Smith's Lead. Cas., 9th ed., and note to the same 1998.

[2] *Ibid.;* citing Dodgson *v.* Scott, 2 Ex. 457; Edwards *v.* Kilkenny Co., 2 Com. B. (N. S.) 397; Philipson *v.* Egremont, 6 Ad. & El. (N. S.) 587; Bosanquet *v.* Graham, 6 Ad. & El. (N. S.) 601, note; Green *v.* Nixon, 23 Beav. 530. The first two of these cases, and Harvey *v.* Scott, 11 Ad. & El. (N. S.) 92, show that it is not proper to raise the question of fraud upon a motion for leave to issue a *scire facias.*

perceived why a defendant, sued upon a judgment, who was not in strictness a party to the record in which the judgment was rendered, should not be allowed to set up, as a reason why it should not be enforced against him, that it was procured to be rendered by collusion and fraud. Such was the view taken in a Federal case where the creditor of the corporation had exclusive control of its management and elected its board of directors. He brought a collusive suit, which was defended only formally by one of the directors of his own creation, and obtained judgment for a large amount. He then sued a county in equity to have the amount due from the county to the corporation on an unpaid subscription to its stock applied on his judgment. The county was not a party to the suit against the corporation in which the debt was established. It was held that the county could be heard upon the question of the amount of the true indebtedness of the corporation to the plaintiff, notwithstanding the judgment; and also that plaintiff, being himself a stockholder, must, as such, contribute to the payment of the debt of the corporation to him.[1]

§ 3401. Conclusiveness of Judgments by Default. — In the absence of fraud, a judgment against the corporation *by default* is as conclusive as a judgment in an action which has been defended.[2]

§ 3402. Going behind the Judgment where the Stockholder is Liable only for a Particular Class of Debts. — If the stockholder is made liable only for a particular class of debts, or only for debts due to a particular class of persons, then it is necessary, under either of the foregoing rules, to go behind the judgment so far as to prove that the debt then recovered upon belonged to the class embraced in the statute. It has been so held under a statute making the stockholders of a railway company jointly and severally liable for moneys due

[1] Bissit *v.* Kentucky River Nav. Co., 15 Fed. Rep. 353. See, also, Ex parte Chorley, L. R. 11 Eq. 157.

[2] Green *v.* Nixon, 23 Beav. 530.

by the corporation to their *servants* for their *wages*.[1] So, where the statute made the stockholder liable for *all debts except loans*, the stockholder could, after judgment against the company, contest his liability, on the ground that the debt recovered upon was for money loaned.[2] So, where the stockholder is liable only for debts of the corporation *contracted at a given period*,[3] and the record of the judgment against the corporation does not show at what period the debt therein recovered upon was contracted, evidence *aliunde* is necessary to fix such date; and without such evidence the judgment is not effective to charge a stockholder.[4] Again, we have already seen that a statute making the stockholders liable for the *debts* of the corporation does not, in the view of some courts, make them liable for its *torts*.[5] Where the action against the corporation is for a *tort*, the cause of action is not so far merged in the judgment recovered by the plaintiff that the judgment becomes a *debt* of the corporation, within the meaning thus put upon such a statute; but a court will look behind the judgment, and inquire into the nature of the demand in which it was founded, and evidence *aliunde* is admissible for this purpose.[6]

§ 3403. Judgment against Corporation after Dissolution not Evidence to Charge Stockholder. — But although the assets of a defunct corporation are subject to be collected and administered by a court of equity for the benefit of its creditors, yet a judgment at law cannot be rendered against a dead corporation any more than against a dead man.[7] A reasonable deduction from this rule is that a judgment recovered against a corporation *after it has been dissolved* is not even *prima facie* evidence of a debt due from the corporation at the

[1] Conant *v.* Van Schaick, 24 Barb. (N. Y.) 87. In such a case the burden is on the creditor to prove that the debt was one for which the stockholder is liable. *Ibid.*

[2] Wilson *v.* The Stockholders, 43 Pa. St. 424.

[3] *Ante*, § 3076.

[4] Larrabee *v.* Baldwin, 35 Cal. 155.

[5] *Ante*, § 3111.

[6] Bohn *v.* Brown, 33 Mich. 257.

[7] Merrill *v.* Suffolk Bank, 31 Me. 57; *s. c.* 50 Am. Dec. 649; Mumma *v.* Potomac Co., 8 Pet. (U. S.) 281, 287; *post*, ch. 156.

time of its dissolution, for the purpose of charging those who were then its stockholders.[1] The record of a void judgment, it should seem, cannot be evidence for any purpose, except, perhaps, for the purpose of proving that a void judgment has been rendered. But, notwithstanding the dissolution of the corporation, a creditor may, in New York, sue a stockholder and recover upon his original demand.[2] Neither was a note given by the vice-president of a corporation after its insolvency, under the corporate seal, evidence to charge the stockholders after a dissolution of the corporation, without showing that it was for a debt actually due by the corporation.[3] And while there is no legal impediment in the way of a creditor of a corporation prosecuting his demand to judgment even after a proceeding has been commenced to dissolve the corporation and wind up its affairs, provided his action was commenced prior to the commencement of such proceeding, unless the prosecution of actions against the corporation has been *enjoined*,[4] yet it has been held that a judgment recovered against a *national bank* in an action commenced three years after the bank went into liquidation, in the manner provided by the National Currency Act, was not binding on the stockholders in the sense that it could not be re-examined, but that they were entitled to go behind it and recontest the matters litigated in the suit which led to it.[5]

[1] Bonaffe *v.* Fowler, 7 Paige (N. Y.), 576. And see the reasoning in Kincaid *v.* Dwinelle, 59 N. Y. 548; and repeated in Hardman *v.* Sage, 124 N. Y. 25, 33.

[2] *Ibid.*

[3] *Ibid.*

[4] *Post*, ch. 156.

[5] Schrader *v.* Manufacturers' Nat. Bank, 133 U. S. 67, 77. Mr. Justice Blatchford, who wrote the opinion of the court in this case, inadvertently cites some of the New York cases, already considered (*ante*, § 3399), which hold that, in a proceeding to charge a stockholder, the judgment which the creditor may have obtained against the corporation is neither conclusive nor *prima facie* evidence against the stockholder. He also cites Trippe *v.* Huncheon, 82 Ind. 307. This last decision, quoting and following the decisions in New York, holds that the liability of the members of the association involved in that case was not upon the *judgment* which the creditor had recovered against the association, but for the *original debt*, as *individuals*, and not as copartners; and therefore that a complaint against them founded upon the judgment against the corporation was bad on

§ 3404. Decree Assessing Shareholders in Winding-up Proceedings Conclusive without Personal Service. — The principle of the preceding section has no application to a case where a corporation has suspended business by reason of insolvency, and a receiver or trustee has been appointed by a court of equity, in a proceeding instituted by or on behalf of its creditors to wind up its affairs and administer its assets. In such a case the court will, according to the usual course of practice in chancery cases, take and state an account of the assets and liabilities of the corporation, and of what is due from its shareholders in the aggregate, and from each of them respectively; and will, upon the basis thus furnished, make an interlocutory decree ordering an assessment upon the shareholders to raise money to liquidate its debts and to pay the costs of the proceeding. This interlocutory decree will be conclusive upon all shareholders, resident and non-resident, whether they were served with process, or made parties to the winding-up proceeding, or not. The theory is, that the corporation is still in a sense their agent, and that they are parties to the proceeding by representation.[1] Theories in support of this conclusion might be considerably expanded; but the best possible reason which can be given for it is, that it is absolutely necessary to the doing of full justice in such a case.[2] If it were required to make the stockholders parties

demurrer. This, it is perceived (*ante*, § 3392), is not the general doctrine of the courts, and especially not the doctrine of the Supreme Court of the United States, as will more strongly appear from the next section.

[1] Hawkins *v.* Glenn, 131 U. S. 319; Glenn *v.* Liggett, 135 U. S. 533; *s. c.* 8 Rail. & Corp. L. J. 52; Howard *v.* Glenn, 85 Ga. 238; *s. c.* 21 Am. St. Rep. 156; 11 S. E. Rep. 610; Sanger *v.* Upton, 91 U. S. 56; Morgan County *v.* Allen, 103 U. S. 498, 509; Glenn *v.* Williams, 60 Md. 93, 116; Hamilton *v.* Glenn, 85 Va. 901; *s. c.* 9 S. E. Rep. 129; Vanderwerken *v.* Glenn, 85 Va. 9; Lewis *v.* Glenn, 84 Va. 947; Glenn *v.* Semple, 80 Ala. 159; *s. c.* 60 Am. Rep. 92.

[2] In such a case it was said: "If the decree were held to be totally without effect as against the stockholders, because they were not parties to it in their individual capacities, the consequence would be that the creditors would be without adequate remedy. It is apparent, indeed conceded, that the stockholders are distributed among several States, and but a comparatively small number of them reside in Virginia. No ordinary process from the courts of that State

defendant to the winding-up proceeding in order to charge them as stockholders, then the burden would be thrown upon such as happen to live within the jurisdiction so as to be amenable to the service of process; or else the inconvenient, and possibly impracticable, device of instituting auxiliary suits in equity in other jurisdictions would have to be resorted to.[1] This rule, then, is the only rule which will do complete justice in such a case; and it is the duty of the corporation, defending through its proper officers, to see that an excessive assessment is not ordered, and that the assessment which is ordered is just and ratable according to each shareholder's liability; and if the corporation is guilty of a default in the performance of this duty, the observation may be made which was made in another relation: "That it would seem to be singular if the stockholders could protect themselves from paying what they owe by setting up the default of their own agents."[2] Moreover, while, as already seen,[3] and as hereafter seen,[4] the shareholders of a corporation are not in all respects in privity with it in such a sense as to be affected with notice to the corporation, yet when the corporation becomes insolvent, and the money which the stockholders have subscribed for their shares is needed to liquidate its debts, this principle ought not to obtain, and does not obtain. In such a case the suspension and insolvency of a corporation has such an important effect upon the rights of the shareholders that all of them, no matter within what jurisdiction they reside, may fairly be presumed to have knowledge of it, and consequently to be affected with knowl-

could reach the non-residents, and in a proceeding where the defendants are sought to be bound or affected by a judgment or decree *in personam*, no constructive notice by publication, or actual service of process beyond the State, will have any effect to give the court jurisdiction over the party. Pennoyer *v.* Neff, 95 U. S. 714. If, therefore, the stockholders were necessary parties in such a proceeding, the creditors would be without any adequate redress as against the stockholders, or, at best, the remedy would be very imperfect, and difficult to pursue." Glenn *v.* Williams, 60 Md. 93, 115, opinion by Alvey, J.

[1] As to the impracticability of this, see *post*, § 3493, *et seq.*

[2] Hatch *v.* Dana, 101 U. S. 205, 214.

[3] *Ante*, §§ 1081, 3395.

[4] *Post*, § 5234.

edge of a general proceeding in equity to wind up its affairs and liquidate its debts. Having knowledge of such proceeding, if any stockholder desires to become a party, the court would permit him to become such in the exercise of a sound discretion, as a proper, though not a necessary, party.[1] But the reasons given by the Supreme Court of the United States in support of the conclusion that all the stockholders, domestic and foreign, are in such a case bound by representation, are, in substance, that in respect of corporate matters, even after insolvency and the commencement of winding-up proceedings, the stockholder is in privity with the corporation. "It cannot be doubted," said Mr. Chief Justice Fuller, "that a decree against a corporation in respect to corporate matters, such as the making of an assessment in the discharge of a duty resting on the corporation, necessarily binds its members in the absence of fraud, and that this is involved in the contract created in becoming a stockholder."[2]

[1] The Virginia Court of Appeals, however, denied a petition of stockholders to be made parties in the winding-up proceeding of the National Express & Transportation Company. Hamilton *v.* Glenn, 85 Va. 901. In Glenn *v.* Williams, 60 Md. 93, 116, speaking with reference to the same proceeding, it was said by Alvey, J., that "the stockholders are *not proper parties*, except as they are represented by the corporation; and if they, in their separate capacities, can be allowed to intervene at all, it can only be through and in the name of the corporation." But while they are undoubtedly not proper parties (except in default of the corporation to represent them — *post*, ch. 62, art. II) for the purpose of defending actions involving the rights and obligations of the corporation, yet where the very object of the proceeding is to charge them distributively, no good reason is perceived why they should be *refused* permission to intervene and defend. Effect of "*balance order*," under English Companies Act, which is a summary order made by the court, requiring the shareholders to pay any balance due by them to the company in respect of their shares for the purpose of liquidating debts, with the conclusion that it is *not a judgment*, nor in the nature of a judgment, and does not *merge* nor estop the bringing in the name of the company of a common-law action for debt: Westmoreland &c. Co. *v.* Fielden [1891], 3 Ch. 15. See, also, Chalk *v.* Tennent, 57 L. T. (N. S.) 598; *s. c.* 36 Week. Rep. 263. "A merger," said Bowen, L. J., "is intended to operate where a *higher remedy* is required which is coextensive with the original demand, as is shown by the cases cited in Boaler *v.* Mayor, 19 Com. B. (N. S.) 76." Westmoreland *v.* Fielden [1891], 3 Ch. 26.

[2] Hawkins *v.* Glenn, 131 U. S. 319, 332; again quoted and reaffirmed in Glenn *v.* Liggett, 135 U. S. 533, 544.

§ 3405. Whether Suit against Stockholder is upon Judgment or Original Demand. — In New York, where the rule is, that the liability of a stockholder is, in a qualified sense, that of a partner,[1] it has been held that, although the statute requires that a judgment shall have been obtained against the company before an action can be prosecuted against a stockholder, yet the action against the stockholder is *on the original demand*, and not on the judgment.[2] The uniform practice in that State seems to have conformed to this view,[3] and, under the rulings in that State, that the judgment is not even *prima facie* evidence of the existence of a debt of the corporation, this is necessarily so.[4] In an early case in South Carolina, decided by Chancellor Desaussure in 1826, and affirmed by the Court of Errors in 1828, a bill in equity was sustained against individual corporators, on a contract made with the company, for a discovery of funds to satisfy the contract; the court proceeding upon the principle that where it appears that the funds of a company are to be raised by future installments, to be called for as the demands against the company shall require them, equity will regard the capital as consisting of the individual credit of the corporators, and will subject them to contribute to the satisfaction of demands arising on contracts while they were members.[5] This case, it will be remembered, much resembles the celebrated case of Dr. Salmon *v.* The Hamborough Company,[6] already examined. It is exceptional in respect of the fact that it does not require the creditor to exhaust his remedy at law, by judgment, execution, and return of *nulla bona*,[7] before going into equity. It has also been questioned, in so far as it holds that individual corporators may be liable for debts contracted, with their

[1] *Ante*, §§ 3074, 3396.

[2] Bailey *v.* Bancker, 3 Hill (N. Y.), 188; *s. c.* 38 Am. Dec. 625.

[3] Moss *v.* McCullough, 5 Hill (N. Y.), 131; Moss *v.* Averell, 10 N. Y. 449; Belmont *v.* Coleman, 21 N. Y. 96; Conant *v.* Van Schaick, 24 Barb. (N. Y.) 87.

[4] *Ante*, § 3396.

[5] Hume *v.* Winyaw &c. Canal Co., 1 Car. L. J. 217.

[6] 1 Cas. in Ch. 204; *s. c.* 1 Kyd Corp. 273. See, as to this case, Thomp. Stockh., § 16.

[7] *Ante*, § 3357.

consent, beyond the amount of their capital stock.[1] So, in Connecticut, where an act of incorporation provided "that the persons and property of the members of the corporation shall, at all times, be liable for all debts due by said corporation," it was held that the members were liable in an original manner, as if no incorporation existed, and therefore no *scire facias* could be maintained against them on a judgment against the corporation.[2]

§ **3406. Right of Stockholder to Appeal or Prosecute Error from Judgment against Corporation.** — The rule that the stockholder is bound by the judgment against the corporation works no hardship, where he is allowed to prosecute an appeal or writ of error to reverse the same; but no such right exists except under very special statutes or rules of procedure. In an early case in California there is a *dictum* to the effect that if a decree, in a proceeding by a creditor against a corporation, erroneously authorizes execution against stockholders, it is for them, not for the corporation, to appeal therefrom.[3] In Maine, it has been ruled that a stockholder, liable for the debts of the corporation, is so far privy to the proceedings to which the corporation is a party that he may bring error to reverse a judgment against it; but the judgment is valid as against him until reversed.[4] In the same State it has been ruled that where a judgment has been recovered against a bank, *after its charter had been revoked*, any stockholder, whose property has been levied upon by execution thereon, may maintain a writ of error to reverse it.[5]

[1] Hightower *v.* Thornton, 8 Ga. 486, 499; *s. c.* 52 Am. Dec. 412, *per* Lumpkin, J.

[2] Southmayd *v.* Russ, 3 Conn. 52.

[3] Dennis *v.* Table &c. Co., 10 Cal. 369.

[4] Came *v.* Brigham, 39 Me. 35.

[5] Rankin *v.* Sherwood, 33 Me. 509. If execution issues against a stockholder illegally upon a judgment against the corporation, the stockholder has, under a statute of Georgia (Code Ga. 1873, § 3375), a remedy peculiar to that State called an "*illegality*," under which it seems that he will be permitted to contest the merits of the judgment against the corporation; as to which, see Thomp. Stockh., § 333; Lowry *v.* Parsons, 52 Ga. 356; Heard *v.* Sibley, 52 Ga. 310.

§ 3407. Recitals in Judgment against Corporation not Evidence against Stockholder. — In an action against a stockholder, based on a decree against the corporation to which he was not a party, either actually or constructively, recitals therein are not admissible.[1]

§ 3408. Judgment against Stockholders in Actions against the Corporation. — Cases are found, influenced by statutes or by very special conceptions of procedure, where it is held that in an action against the company, where evidence is given to show who are the members who compose it, judgment may be rendered against them individually.[2] In an early case it was held that judgment may be entered against defendants individually, who are named and described in the complaint as a certain company, although they are not members of it, if the jury find that they are liable individually.[3] In considering this question the principle cannot be ignored that the corporation is one person in law, and that the individual stockholder is another and a distinct person, although the latter is in privity with the former, and is to a certain extent bound by judgments recovered against it.

§ 3409. Conclusiveness of Judgment in Supplementary Proceeding against Stockholder. — Where a judgment has been obtained against a corporation, and a supplementary proceeding instituted, under a statute, to charge the stockholders individually therewith, the judgment thus obtained against the stockholders is equally conclusive; it establishes the right of the creditor to have execution against the stockholder, and cannot be questioned by the latter in a bill to enjoin such execution.[4]

[1] Chestnut *v.* Pennell, 92 Ill. 55. As to the former practice in England of *suggesting on the record* of the judgment against the corporation *the liability of a member* — similar to that allowed by *motion* in Missouri (*post*, § 3602, *et seq.*), — see Bartlett *v.* Pentland, 1 Barn. & Adol. 704; Sainter *v.* Fergusson, 8 Com B. 619; *s. c.* 7 Dowl. & L. 301.

[2] Gillig *v.* Lake Bigler &c. Co., 2 Nev. 214.

[3] Comanche Mining Co. *v.* Rumley, 1 Mont. 201.

[4] Hampson *v.* Weare, 4 Iowa, 13; *s. c.* 66 Am. Dec. 116.

CHAPTER LXI.

REMEDIES AND PROCEDURE.

ART. I. THEORIES AND STATUTES UNDER WHICH REMEDY IS AT LAW. §§ 3413–3424.
II. THEORIES AND STATUTES UNDER WHICH REMEDY IS IN EQUITY. §§ 3428–3442.
III. WHERE THE CREDITOR IS ALSO A STOCKHOLDER. §§ 3446–3450.
IV. RULES IN PARTICULAR JURISDICTIONS. §§ 3453–3476.

ARTICLE I. THEORIES AND STATUTES UNDER WHICH REMEDY IS AT LAW.

SECTION
3413. Remedy at law where stockholder in default in payment of calls.
3414. Doctrine that where statute creates a right and prescribes no remedy, remedy at law.
3415. Remedy at law where liability is that of a partner.
3416. When legal and equitable remedies concurrent.
3417. Right of individual creditors to proceed at law ousted by a general winding-up proceeding.
3418. When the remedy exists at law.
3419. Receiver, assignee, or trustee may sue at law for assessments.
3420. Creditor's bill, when not practicable.
3421. Bill in equity by receiver of a corporation against its stockholders.
3422. In case of a foreign corporation.
3423. Continued: distinction between a contractual and a statutory liability.
3424. Continued, with illustrative holdings.

§ 3413. Remedy at Law where Stockholder in Default in Payment of Calls.—Where *calls have been made* by the directors, and the stockholders have been notified of them in compliance with the governing statute,[1] or where a resolution

[1] *Ante*, § 1747, *et seq.*

assessing them has been made by the directors in those jurisdictions which dispense with notice,[1] so that *a debt is owing* by the stockholder to the corporation, which is presently due and payable,—a separate creditor need not resort to equity, but has a remedy at law by *garnishment* under his execution against the stockholders. And so if the grounds exist which will support an *attachment* against the corporation, it may equally be concluded that it may be levied upon the stockholders by *garnishment* in such a case.[2]

§ 3414. Doctrine that where Statute Creates a Right and Prescribes no Remedy, Remedy at Law.—In Illinois, where, as is well known, legal and equitable remedies have not been blended under a code, but where the ancient line of demarkation between these remedies still subsists,—although they are administered in the same court and by the same judge,—the doctrine is laid down, with reference to the subject under consideration, that where a statute creates a liability, the remedy is invariably at law, unless the statute provides for proceedings in equity. "This," said Mr. Justice Walker, "is so well understood as to require no discussion or citation of authorities."[3] The theory of the first case in Illinois, where it was held that the remedy was at law, was that where a statute creates a liability, "an *implied promise* arises out of this liability."[4] It is believed that neither of these propositions is sound, but that the larger and better view is, that where the Legislature creates a right and omits to prescribe a remedy for the enforcement of it, it impliedly charges the judicial branch of the government with applying the appropriate remedy according to the course of its procedure, which may be at law or in equity, according to the nature of the right created.[5]

[1] *Ante*, § 1748, *et seq.*

[2] Allen *v.* Montgomery &c. R. Co., 11 Ala. 437; *post*, § 3577, *et seq.*

[3] Wincock *v.* Turpin, 96 Ill. 135, 142.

[4] Culver *v.* Third Nat. Bank, 64 Ill. 528, 538.

[5] This is the view taken in Wisconsin. Sleeper *v.* Goodwin, 67 Wis. 577, 587. See, also, Flour City Nat. Bank *v.* Wechselberg, 45 Fed. Rep. 547.

§ 3415. Remedy at Law where Liability is That of a Partner.—In several cases of statutory liability resembling that of partners, it has been held that an action at law would lie.[1] It was so held under a statute which provided that, in the event of the insolvency of a corporation, its stockholders should be responsible for its debts *in their private capacity;*[2] and under a statute providing that the *persons and property of the members of a corporation should at all times be liable* for debts due by the corporation.[3]

§ 3416. When Legal and Equitable Remedies Concurrent.—The rule obtaining in some of the States, in case of a superadded *statutory liability*, is that the creditor has a *concurrent remedy at law.*[4] This rule, in several cases, arises by force

[1] See Simonson *v.* Spencer, 15 Wend. (N. Y.) 548; Bank of Poughkeepsie *v.* Ibbotson, 24 Wend. (N. Y.) 473. Such is the doctrine in Illinois. *Post*, § 3460; *ante*, § 3078.

[2] Deming *v.* Bull, 10 Conn. 409. Compare Bond *v.* Appleton, 8 Mass. 472; *s. c.* 5 Am. Dec. 111.

[3] Southmayd *v.* Russ, 3 Conn. 52. Compare Middletown Bank *v.* Magill, 5 Conn. 28.

[4] Bank of Poughkeepsie *v.* Ibbotson, 24 Wend.(N.Y.) 473, 479 (leading American case—opinion by Nelson, C. J.); Culver *v.* Third Nat. Bank, 64 Ill. 528, 538; Garrison *v.* Howe, 17 N. Y. 458; Norris *v.* Johnson, 34 Md. 485: Bank of United States *v.* Dallam, 4 Dana (Ky.), 574; Grund *v.* Tucker, 5 Kan. 70, 77; Perry *v.* Turner, 55 Mo. 418; Hall *v.* Klinck, 25 S. C. 348; *s. c.* 60 Am. Rep. 505, 511. Under the National Banking Act, a suit by a receiver, to enforce the statutory liability of the shareholders, if the whole amount is sought to be recovered, must be at law; if only a contribution is required, it may be in equity. Kennedy *v.* Gibson, 8 Wall. (U. S.) 498, 505. The former English statutes were founded on a policy of this kind, under which execution might be had against a shareholder upon a proceeding by *scire facias* after judgment against the company, execution, and a return of *nulla bona;* and many similar statutes exist in this country. But, after a thorough trial of this system, the practical sense of that great commercial people expressed itself in a statute under which an insolvent corporation is wound up in chancery, the court assessing its shareholders, adjusting their mutual equities, and distributing its assets ratably among all its creditors. Companies Act, 1862 (25 & 26 Vict., ch. 89). A single creditor cannot now proceed at law against a shareholder, but must bring his winding-up petition. In Georgia depositors in a bank that has failed may proceed at law for the recovery of their debts under certain provisions of the code (Ga. Code, § 3367, *et seq.*), and enforce the ultimate liability clause of the charter as against the stockholders; or they may seek, in an equitable proceeding, sat-

of statute; but where it has been declared in the silence of statutes, it has been placed on the ground that it affords a direct and inexpensive remedy by which a small creditor may collect his debt from any stockholder, to the extent of the latter's liability, leaving him to support the burden of a suit in equity against his co-members of the corporation for a contribution.

§ **3417. Right of Individual Creditors to Proceed at Law Ousted by a General Winding-up Proceeding.**—Where a suit in equity has been instituted to subject the amount for which the shareholders of a corporation are liable to the common benefit of all the creditors, the very objects which induce these courts to proceed in such cases would be defeated if separate creditors could proceed against separate stockholders at law. It has accordingly been held, under a *statute of individual liability*, that where a suit in equity has been instituted for such a purpose, no creditor can institute a separate suit for the enforcement of such liability in his own behalf.[1] The same principle will apply whenever a general administration of the assets of the insolvent corporation is entered upon in a court of competent jurisdiction, or under its superintendence or authority, whether commenced by a creditor's bill in equity and the appointment of a receiver, or by a voluntary assignment by the corporation to an assignee or a trustee under a State statute, or by a proceeding in bankruptcy under a statute of the United States. To this statement exceptions exist under particular theories and statutory systems, which exceptions are considered in this title in their proper places. The general rule, however, remains, that in the case above stated the right to collect from shareholders what is due in respect of their unpaid subscriptions passes to the *receiver*,[2] *assignee* in

isfaction out of the assets of the bank, legal or equitable, and also a decree against the bank for the full amount of their debts, and may then make this decree a basis for proceeding against the stockholders to enforce their ultimate liability. City Bank v. Crossland, 65 Ga. 734.

[1] Wright *v.* McCormack, 17 Ohio St. 86.

[2] *Post*, § 3551; Cadle *v.* Baker, 20 Wall. (U. S.) 650. In New York, "the

bankruptcy,[1] *assignee* under a State insolvent statute,[2] or other voluntary assignee or trustee for the benefit of creditors;[3] and that he may bring appropriate actions therefor, at law or otherwise. When we say that the assets of the insolvent corporation pass, for the purpose of equitable administration, to the receiver, assignee in bankruptcy, assignee under the State insolvent law, or other voluntary assignee or trustee, we necessarily exclude the idea that any remedy, legal or otherwise, remains to a single creditor against one or more of the stockholders, unless such remedy is reserved by statute or by peculiar judicial theories.[4] On the other hand, where the nature of the liability imposed by the governing statute is such as to indicate that it was not the purpose of the Legislature that the jurisdiction of equity should be excluded, but that it was rather intended to give to any creditor a short road against any stockholder—the institution of a winding-up proceeding in equity is no ground for enjoining the prosecution of a suit at law. In so holding, Chancellor Walworth reasoned that a bill to reach corporate property, which the complainants were unable to reach on their executions, was unobjectionable, and was the more appropriate course, where it was also intended to charge stockholders or directors with corporate debts. In the particular case the stockholders were each liable for debts incurred during the time they were stockholders, but it was necessary that judgment be first had against the corporation and execution be returned unsatisfied. The claims of the creditors against stockholders might turn out to

receiver is the proper person to bring the suit, as he has the legal title to all the property of the company,—being vested by the Revised Statutes with all the rights given by law to trustees or assignees of insolvent debtors." Nathan *v.* Whitlock, 9 Paige (N. Y.), 152, 159.

[1] *Post*, § 3551; Webster *v.* Upton, 91 U. S. 65; Sanger *v.* Upton, 91 U. S. 56.

[2] *Post*, § 3551; Lionberger *v.* Broadway Sav. Bank, 10 Mo. App. 499; Boeppler *v.* Menown, 17 Mo. App. 447, 450; Shockley *v.* Fisher, 75 Mo. 498; Eppright *v.* Nickerson, 78 Mo. 482.

[3] A good illustration of this is found in the already celebrated Glenn cases, beginning with Lewis *v.* Glenn, 84 Va. 947, and having counterparts in the Federal and many of the State courts. *Post*, § 3551, *et seq.* See, also, *ante*, § 2059.

[4] So held in Branch *v.* Knapp, 61 Ga. 614.

be claims against different persons or classes of persons. They would not necessarily be against the same persons. Creditors could not, therefore, be *compelled* to litigate their claims in one suit. If on the filing of a bill by one creditor all the others were to be restrained from proceeding at law, and compelled to litigate their claims in that suit, they might be cut off from their remedy against stockholders, whom the party filing the bill could not bring in, because he had no claim against them.[1]

§ **3418. When the Remedy Exists at Law.**—The courts have met with a great deal of difficulty in determining whether the creditor should in any case be allowed to bring an action against the stockholder directly *at law;* or whether he should not in all cases be remanded to the more flexible and comprehensive remedy offered by courts of equitable powers, where in a single proceeding the court can equally relieve the creditor, and equalize the burdens of the stockholders. It may be stated generally that the remedy at law exists in the following cases: 1. Where the coadventurers have *failed to become incorporate,* so as to be clothed with the immunity from general liability which attaches to members of corporations.[2] 2. Where, for any reason, or upon any contingency or condition, the governing statute makes (or leaves) them jointly and severally *liable as partners,* and the courts construe this liability to be that of original undertakers, and not a secondary liability.[3] Thus, where the object of the creditor is to enforce the personal liability of the stockholder under a statute,[4] making the stockholders personally liable for debts contracted when the corporation attempts to transact business before one-half of its stock is subscribed or twenty per cent of it actually paid in,—the action is necessarily an action at law; for the liability is primary and absolute, and equity has nothing to act upon.[5] 3. In other cases, where the remedy at law

[1] Judson *v.* Rossie Galena Co., 9 Paige (N. Y.), 598; *s. c.* 38 Am. Dec. 569.

[2] *Ante,* § 2969, *et seq.*

[3] *Ante,* § 3078, *et seq.*

[4] Wis. Rev. Stats., § 1773.

[5] Flour City Nat. Bank *v.* Wechselberg, 45 Fed. Rep. 547.

is given by statute, in direct terms, or by such implications as satisfies the courts that it was the intention of the Legislature to give it; and this is often the case with a superadded *individual liability*, which is always a creature of statute, and depending in every case upon the phraseology of the statute, to which close attention is required.[1] 4. Where the liability is for a balance unpaid upon the share subscription or in respect of the shares held by the shareholder, that, on principles often reiterated,[2] is a part of the *assets* of the corporation which passes to its receiver in equity, its assignee under a Federal bankrupt law, or under a State insolvent law, or its voluntary assignee or trustee under its deed of assignment or of trust for the benefit of its creditors; and such *receiver*, *assignee*, or *trustee* will have the right of action against the respective shareholders which the corporation would have had, and may proceed to enforce the collection of the assessments ordered against them, by remedies hereafter pointed out; and this necessarily excludes any right of action by a particular creditor against a particular shareholder, whether at law or in equity.[3]

§ **3419. Receiver, Assignee, or Trustee may Sue at Law for Assessments.**—From what has preceded it follows that where an assessment is made by a court or other official possessing jurisdiction to make it,[4] the receiver, assignee, or trustee, spoken of in the preceding section, may maintain an action at law in any jurisdiction, domestic or foreign, against the several stockholders, to recover from them the amount assessed against them in respect of their share subscriptions,[5] —as, for instance, a receiver appointed by a court of equity under statutory authority,[6] or by the Comptroller of the Cur-

[1] Note the language of Waite, C. J., in Terry *v.* Little, 101 U. S. 216; quoted and reaffirmed in Hall *v.* Klinck, 25 S. C. 348; *s. c.* 60 Am. Rep. 505.

[2] See *ante*, § 2951, *et seq.*

[3] Wheeler *v.* Thayer, 121 Ind. 64; *s. c.* 22 N. E. Rep. 972; *post*, § 3551, *et seq.*

[4] *Ante*, §§ 1705, *et seq.*, 2960, 2961; *post*, § 3537.

[5] *Post*, § 3551.

[6] Nathan *v.* Whitlock, 9 Paige (N. Y.), 152, 159.

rency under the National Banking Act,[1] or an assignee under a State insolvent law,[2] or the receiver of a national bank,[3] or a substituted trustee under a general deed of assignment made by a corporation,[4] or an assignee under a Federal bankrupt law.[5] And such actions have been maintained in the name of the corporation itself, and this is still the rule where the common-law theory of actions prevails, as in the District of Columbia,[6] though the action is, in substance, prosecuted by the receiver, assignee, trustee, or official liquidator, for the benefit of the trust.[7]

§ **3420. Creditors' Bill, when not Practicable.**—Where, under the governing statute, the stockholders, who are liable to creditors of the corporation, are those who were stockholders at the time the particular debt was contracted, it has been held that a general *creditors' bill,* which seeks to enforce the liability of the stockholders, is not an appropriate or practicable remedy. The reason is, that the *creditors* of the corporation, whose debts were contracted at different times, have *no common interest,* and hence their claims will not necessarily be against the same persons as stockholders. No creditor would have the right to file a bill and make all who were or ever had been stockholders of the company, defendants

[1] Cadle *v.* Baker, 20 Wall. (U. S.) 650. And see Kennedy *v.* Gibson, 8 Wall. (U. S.) 505.

[2] Boeppler *v.* Menown, 17 Mo. App. 447; Shockley *v.* Fisher, 75 Mo. 498; Eppright *v.* Nickerson, 78 Mo. 482; Lionberger *v.* Broadway Savings Bank, 10 Mo. App. 499.

[3] Young *v.* Wempe, 46 Fed. Rep. 354. Compare Harvey *v.* Lord, 11 Biss. (U. S.) 144.

[4] Lewis *v.* Glenn, 84 Va. 947; Vanderwerken *v.* Glenn, 85 Va. 9; Glenn *v.* Semple, 80 Ala. 159; *s. c.* 60 Am. Rep. 92; Glenn *v.* Williams, 60 Md. 93; Hawkins *v.* Glenn, 131 U. S. 319.

[5] Sanger *v.* Upton, 91 U. S. 56; Webster *v.* Upton, 91 U. S. 65.

[6] *Post,* § 3570. Compare *ante,* § 1815, *et seq.*

[7] See Hall *v.* United States Ins. Co., 5 Gill (Md.), 484, where in an equity proceeding a call was ordered and a suit therefor ordered to be brought, which was successfully prosecuted in the name of the company. Also, Westmoreland &c. Co. *v.* Fielden [1891], 3 Ch. 15, where an action was successfully prosecuted in the name of the company after the commencement of winding-up proceedings for calls made before winding up.

therein, when some of such defendants might not have been stockholders at the time when their debts were contracted.[1]

§ 3421. **Bill in Equity by Receiver of a Corporation against Its Stockholders.** — Where a receiver has been appointed, and he proceeds against the stockholders to enforce a contribution from them of such sum as the court appointing him may have determined to be necessary to liquidate the debts of the corporation and pay the costs of the winding-up proceedings, he may, it seems, sue in equity as well as at law;[2] and where a receiver of a corporation appointed in New Jersey brought an action against certain stockholders of the corporation domiciled in Massachusetts, in the Circuit Court of the United States for the District of Massachusetts, it was held, but without explaining the reasons, that the suit was well brought in equity.[3] In Maine, a receiver of a solvent banking corporation is allowed to maintain a bill in equity against the stockholders of the corporation to compel them to contribute for the payment of its debts; but this is by force of statute.[4] The ground which will sustain the jurisdiction of equity in such a case is not perceived, for there does not seem to be any scope for equitable relief. For the purpose of establishing a ratable contribution among the stockholders, they should be made parties to the proceeding in which the receiver is appointed, under a theory of procedure elsewhere stated;[5] though, under another theory,[6] those who are not made parties may be bound, by representation through the corporation, in respect of the assessment made against them, — subject to the right

[1] Judson *v.* Rossie Galena Co., 9 Paige (N. Y.), 598; *s. c.* 38 Am. Dec. 569.

[2] *Post*, § 3569.

[3] Andrews *v.* Bacon, 38 Fed. Rep. 777. Mr. Circuit Judge Colt dismissed the point by merely referring to Pollard *v.* Bailey, 20 Wall. (U. S.) 520, which was not such an action at all, but which simply held, under an Alabama charter, that a single *creditor* could not sue a single stockholder at law — not that a *receiver* could not sue at law to enforce an assessment.

[4] Dane *v.* Young, 61 Me. 160; Rev. Stat. Me. 1857, ch. 47, § 73.

[5] *Post*, § 3493.

[6] *Post*, § 3499.

of making possible defense applicable to themselves individually, — and the natural form of the action by the receiver to enforce such an assessment would seem to be an action at law, such as were the numerous actions in the so-called Glenn cases.[1]

§ **3422. In Case of a Foreign Corporation.** — Where the proceeding is against resident stockholders of a foreign corporation, and the law creating the corporation makes the stockholders liable for its debts, but without prescribing a special remedy, the course of proceeding to enforce such liability is necessarily *governed by the law of the forum.*[2] Where the words of the charter merely import a personal liability, an action may be maintained by the creditor against a stockholder in a foreign jurisdiction; but if the governing statute charges the property of the stockholders, and that not generally, by the ordinary process, but conditionally, and by a peculiar and unusual procedure only available in the courts of the State creating the corporation, — not only limiting and prescribing the security and rights of the creditor, but also the obligation and liability of the stockholder, and prescribing the remedy, this remedy goes with this statute as a part of the right, and a general personal liability will not attach to the stockholder, which can be enforced by an action in another jurisdiction.[3] But where the property of the foreign corporation has been divided among its stockholders before all its debts have been paid, a judgment creditor, after the return of an execution unsatisfied, may maintain an action against a domestic stockholder of such foreign corporation, in the nature of a *creditor's bill,* to reach and subject so much of the assets

[1] *Post,* § 3568.

[2] Drinkwater *v.* Portland Marine Ry., 18 Me. 35; Lowry *v.* Inman, 46 N. Y. 119, 126; Leucke *v.* Tredway, 45 Mo. App. 507; First Nat. Bank *v.* Gustin-Minerva &c. Co., 42 Minn. 327; *s. c.* 18 Am. St. Rep. 510; 44 N. W. Rep. 198; 6 L. R. A. 676.

[3] Lowry *v.* Inman, 46 N. Y. 119. To the same effect is Fourth Nat. Bank *v.* Francklyn, 120 U. S. 747, where the opinion, written by Mr. Justice Gray, is a very learned and able exposition of the subject.

of the corporation as were improperly received by him. Such assets being a trust fund for the creditors of the corporation, it is an immaterial inquiry whether the stockholder got possession of them by a fair agreement with his associates or by a wrongful act. The creditor in such a case is not (in New York) required to bring his action in behalf of other creditors who may choose to come in, or to make all the stockholders parties to the action. With the equities subsisting between the stockholders themselves he has nothing to do, unless he chooses to take upon himself the burden of bringing his action in such a form as to adjust them.[1] So, where the corporation is a foreign one, and the domestic creditor has in like manner exhausted his remedy against it, he may, in the same State, bring an action against a domestic stockholder to subject a balance due to the corporation on his share subscription,—such an action being authorized by section 1871 of the New York Code of Procedure.[2]

§ 3423. Continued: Distinction between a Contractual and a Statutory Liability. — Under this head a marked distinction must be taken between the case where the action is to subject what is due by a stockholder as a balance unpaid upon his share subscription, and where the action is to enforce a superadded personal liability. In the first case, the liability *rests in contract,* and does not necessarily depend upon the language of statutes declaring it, although such statutes may exist.[3] As it rests in contract, it is, like any other contractual obligation, relating to personal property, enforceable wherever the obligor, that is to say, the stockholder, may be found.[4] The *validity and effect of the obligation* are determined generally by the law of the domicile of the corporation, and especially by the charter or governing statute of the corporation, for that is deemed to enter into and form a part of the contract;[5] but the *remedy* to enforce such a contractual obligation is applied

[1] Bartlett *v.* Drew, 57 N. Y. 587.

[2] Persch *v.* Simmons, 3 N. Y. Supp. 783.

[3] *Ante,* §§ 1136, 2933.

[4] *Ante,* § 3048.

[5] *Ante,* §§ 3046, 3063.

according to the law of the forum.[1] It follows that, although the Legislature of the State in which the corporation was created may have prescribed a *special remedy* for the enforcement of this contractual obligation, that remedy will not migrate; but where a stockholder is proceeded against in another jurisdiction, the court in that jurisdiction will apply its own appropriate remedy.[2] The case is different from that where the statute of the State in which the corporation exists has *created the right* to proceed against its shareholders, and at the same time prescribed a *special remedy* for the enforcement of that right. Here only the special remedy can be applied; and if that remedy is contrary to the course of the court in the foreign State in which it is sought to charge the stockholder, it seems that there is no remedy against him.[3] But in the special case we are considering, the case where the liability is in respect of a *balance due* the corporation for the shares, the right is not created by statute, but is created by the contract which the subscriber makes when he agrees to take the shares, and which his assignee makes when he purchases them from him before they are paid for, and becomes substituted as their allottee in his place by a species of novation. It is, therefore, a right resting not on statute, but in contract, and is hence enforceable everywhere, according to the law of the forum in which the stockholder may be found.[4]

§ **3424. Continued, with Illustrative Holdings.** — Accordingly, where the action was by a single creditor of a corporation created under the laws of Illinois, in one case, against a single stockholder domiciled in Missouri,[5] and in another against two stockholders domiciled in that State,[6] and the nature of the proceeding was that of a creditor's bill in equity to subject what was unpaid by the defendants upon their

[1] *Ante*, § 3064; First Nat. Bank *v.* Gustin-Minerva &c. Co., 42 Minn. 327; *s. c.* 18 Am. St. Rep. 510.

[2] Leucke *v.* Tredway, 45 Mo. App. 507. Compare *ante*, § 3054.

[3] May *v.* Black, 77 Wis. 101; *s. c.* 45 N. W. Rep. 949.

[4] Mann *v.* Cook, 20 Conn. 178.

[5] Shickle *v.* Watts, 94 Mo. 410.

[6] Leucke *v.* Tredway, 45 Mo. App. 507.

shares, — the court, disregarding the question what remedy would be applied in Illinois, held that a bill in equity was an appropriate remedy in Missouri, especially in view of the fact that the defendants had failed to plead the existence of a remedy at law. The Supreme Court of Illinois, while allowing a remedy in equity against *resident stockholders* of domestic corporations where the liability, although statutory, is to the *creditors as a class*,[1] deny a remedy in equity to particular creditors of a *non-resident corporation* against stockholders domiciled within the State of Illinois, even where the object of the bill is to sequester what is due by such stockholders to the corporation in respect of their share subscriptions, and consequently where the liability is one strictly resting in contract, and enforceable everywhere, according to principles already stated.[2] The Illinois court adopt and follow the doctrine of the Supreme Judicial Court of Massachusetts, as laid down in a case in the following language: "The liability which the stockholders are alleged to be under to the corporation and its creditors has little analogy to a debt due according to the generally recognized principles of law. It is of a peculiar character, involving the organic law by which the corporation is created, and *requiring local administration*."[3] The court also advanced a number of reasons, more or less specious, for repelling the jurisdiction, among them the consideration that no discovery can be had of other stockholders and creditors; that no account can be taken of the debts of the corporation, no ratable assessment or ratable distribution made, etc. This, though not the language, is the substance of the reasoning; and it operates to drive any creditor, however small, to the expense of filing a general winding-up bill in equity within the State under whose laws the corporation is organized. The inconvenience of such a rule in its application to a "tramp corporation," created under the laws of

[1] *Post*, § 3460.

[2] Young *v.* Farwell, 139 Ill. 326; *s. c.* 28 N. E. Rep. 845; affirming *s. c.* 35 Ill. App. 469.

[3] New Haven etc. Co. *v.* Linden Spring Co., 142 Mass. 349, 353. As to the *Massachusetts doctrine*, see *ante*, §§ 3056, 3058, 3059.

West Virginia, for instance, all of whose stockholders might be residents of the State of Illinois, can be readily imagined; but perhaps the court would apply a different rule if such a case were presented. It is perceived that the Illinois decision is explicitly opposed to the two Missouri decisions above cited.

ARTICLE II. THEORIES AND STATUTES UNDER WHICH THE REMEDY IS IN EQUITY.

SECTION
3428. Grounds of stockholders' liability in equity: holding assets of the corporation.
3429. As where they have not paid up their share subscriptions.
3430. Or where the assets have been improperly divided among the stockholders.
3431. In case of a statutory individual liability.
3432. Reasons of the doctrine that the equity forum is exclusive.
3433. Where the proceeding is to enforce contracts made in behalf of the corporation prior to its organization.
3434. Remedy in equity where statute liability is to creditors as a class.
3435. Or where the statute creates a common fund for creditors.
3436. Inapplicability of the doctrine that equity will not relieve one who has a remedy at law.
3437. Grounds on which concurrent jurisdiction in equity supported.
3438. On the ground of discovery.
3439. Bill by a foreign corporation to discover domestic stockholders.
3440. Where the liability is in proportion to the stock held.
3441. In case of deceased shareholders.
3442. When court will not restrain proceedings at law.

§ 3428. Grounds of Stockholders' Liability in Equity: Holding Assets of the Corporation.—While the *general rule of law* which exempts the members of a corporation from liability for its debts,[1] is, of course, a rule of equity, as well as a rule of common law,—yet, on a theory already considered,[2] courts of equity are, in many instances, able to aid the creditors of a corporation, upon the ground that the members *have in their possession assets of the corporation* which, as against its creditors, they ought not in good conscience to retain.[3]

[1] *Ante*, § 2925.

[2] *Ante*, § 2951, *et seq.*

[3] "We are aware of no decision which holds, on the dissolution of a corporation, that any of its members becomes liable for its debts beyond

§ 3429. As Where They Have Not Paid Up Their Share Subscriptions. — Shareholders occupy this position when they have subscribed moneys to the capital stock of the corporation, which they have not paid in. They are holders of the capital stock to the extent of the shares they have taken, until it is required by the company.[1] And where the corporation has *assigned* all its property in trust for the benefit of its creditors, equity has jurisdiction to subject the unpaid stock subscriptions to the payment of its debts, without reference to the inquiry whether the unpaid subscriptions do or do not pass by the deed of trust.[2] A general view of this subject leaves no doubt that where the creditor does not seek to enforce a *statutory* liability, or a liability akin to that of *partners*, but merely seeks to subject what is due by the shareholders to the corporation whose shares have not been paid up in full, the appropriate forum is *equity* after exhausting the ordinary remedies at law;[3] and where the remedy has not been enlarged by statute, some of the courts have held that

the value of its assets he may have in his possession." Walker, J., in Tarbell *v.* Page, 24 Ill. 46. The doctrine of the text is well illustrated by the case of Bigelow *v.* Congregational Society, 11 Vt. 283, and 15 Vt. 370. There the members of a religious corporation dissipated a fund in their hands in defending a suit which had been brought against them. The plaintiff, having obtained a judgment at law, filed a bill in equity in aid of his execution. The court decreed that an account be taken of the state of the fund at the time the action at law was commenced; that it be subjected to the payment of the plaintiff's demand, and if there was not enough, that the members respond personally for so much, if necessary, as would restore the fund to its original dimensions. Another apt illustration is afforded by the case of Tinkham *v.* Borst, 31 Barb. (N. Y.) 407, where an action was sustained by a creditor against the sole stockholder of a dissolved foreign corporation, who was in possession of its assets.

[1] Lord St. Leonards in Spackman *v.* Evans, L. R. 3 H. L. 198.

[2] Hamilton *v.* Glenn, 85 Va. 901; *s. c.* 9 S. E. Rep. 129.

[3] *Ante*, § 2951, *et seq.;* Hume *v.* Winyaw Co.,, Car. L. J. 217; Mann *v.* Pentz, 3 N. Y. 415; Marsh *v.* Burroughs, 1 Woods (U. S.), 463; Miers *v.* Zanesville Co., 11 Ohio, 273; *s. c.* 13 Ohio, 197; Henry *v.* Vermillion, &c. R. Co., 17 Ohio, 187; Leucke *v.* Tredway, 45 Mo. App. 507; Hickling *v.* Wilson, 104 Ill. 54; Harmon *v.* Page, 62 Cal. 448; Masters *v.* Rossie Lead Mining Co., 2 Sandf. Ch. (N. Y.) 301; Foster *v.* Mullanphy Planing Mill Co., 92 Mo. 79; Tabor *v.* Goss &c. Man. Co., 11 Col. 419 (under a statute); Wellington *v.* Continental Const. & Imp. Co., 5 N. Y. Supp.

this is the exclusive forum.[1] The most usual statement of doctrine under this head is that when a creditor has exhausted his legal remedies against the corporation, which fails to make an assessment, he may, by bill in equity or other appropriate means, subject such subscriptions to the satisfaction of his judgment.[2] That is to say, where a creditor of a corporation having an execution at law, which is unsatisfied, institutes proceedings against the company and the effects of the company are insufficient to pay its debts, he may have relief in equity to compel the payment of the sums due and unpaid on the shares of the delinquent stockholders.[3]

§ 3430. Or Where the Assets Have Been Improperly Divided Among the Stockholders. — A bill in equity is, in like manner, the proper remedy where the assets of the corporation have, in any form of transaction or under any pretense, been *improperly divided* among the stockholders, leaving its debts unpaid;[4] and in this instance *equity is the exclusive remedy*, for a common-law action as for a tort will not lie on behalf of a creditor against a stockholder so improperly receiving the

587; *s. c.* 52 Hun (N. Y.), 408. Therefore, a statute providing for the determination of such matters by a proceeding before a referee is not unconstitutional as denying a trial by jury, for they were always cognizable in chancery, where juries were called only on the direction of the chancellor. Matter of Empire City Bank, 18 N. Y. 199, 210. See also Hightower *v.* Mustian, 8 Ga. 506.

[1] Spear *v.* Grant, 16 Mass. 9; Harris *v.* First Parish in Dorchester, 23 Pick. 112; Knowlton *v.* Ackley, 8 Cush. 93; Erickson *v.* Nesmith, 15 Gray (Mass.), 221; Smith *v.* Huckabee, 53 Ala. 191; Pollard *v.* Bailey, 20 Wall. (U. S.) 520; Umsted *v.* Buskirk, 17 Ohio St. 113; Jones *v.* Jarman, 34 Ark. 323; Griffith *v.* Mangam, 73 N. Y. 611; Wellington *v.* Continental &c. Co., 5 N. Y. Supp. 587; Rounds *v.* McCormick, 114 Ill. 252; Brown *v.* Fisk, 23 Fed. Rep. 228. In some States the exclusive jurisdiction of equity has been declared by statute. Act N. H., June 27, 1857; Pamph. Laws, ch. 1962; Hadley *v.* Russell, 40 N. H. 109.

[2] Hawkins *v.* Glenn, 131 U. S. 319.

[3] Mann *v.* Pentz, 3 N. Y. 415; Henry *v.* Vermillion &c. R. Co., 17 Ohio, 187; Miers *v.* Zanesville Turnpike Co., 11 Ohio, 273; *s. c.* 13 Ohio, 197; Atwood *v.* Rhode Island &c. Bank, 1 R. I. 376.

[4] Wood *v.* Dummer, 3 Mason (U. S.), 308: Bartlett *v.* Drew, 57 N. Y. 587. Compare *ante*, § 2954.

assets of the corporation;[1] and consequently until the equity system had been introduced by statute in Massachusetts there was, in such a case, *no remedy*.[2] A judgment creditor, having exhausted his remedy by suing out an execution which has been returned *nulla bona*, may, under such circumstances, maintain a *creditor's bill* in equity, or, under the modern codes, an action of that nature, against a stockholder, to reach and subject as a *trust fund* whatever was so wrongfully received by him; and it is immaterial whether he got it by a fair agreement with his associates or by acts wrongful as against them.[3] In such a case it was held that a bill in equity might be maintained by *some* of the holders of the notes of an insolvent banking corporation against *some* of the stockholders, to subject them to liability for the payment of the corporate debts, the impossibility of bringing all before the court being a sufficient excuse for dispensing with the other parties in interest.[4]

§ 3431. In Case of a Statutory Individual Liability.—The considerations which claim for courts of equity an *exclusive jurisdiction* of a proceeding to call in, for the benefit of creditors, debts due by shareholders on account of their stock subscriptions, are of nearly equal force where the liability is created by statute. In some of the States, courts of equity take exclusive jurisdiction of such cases, for the purpose of adjusting equities and preventing a *multiplicity of suits*. In others, this forum is preferred, on the ground that the doing of full justice involves complex *contributions* among the stockholders, which cannot be worked out by the processes of a court of law.[5] But, on whatever ground the conclusion has been put, there is a very great concurrence of opinion to the effect that, where it is sought to charge the stockholders in

[1] Vose *v.* Grant, 15 Mass. 505; Spear *v.* Grant, 16 Mass. 9.

[2] *Ibid.* That the remedy is now exclusively in equity in Massachusetts, see Bond *v.* Morse, 9 Allen (Mass.), 471.

[3] Bartlett *v.* Drew, *supra.*

[4] Wood *v.* Dummer, *supra.*

[5] Atwood *v.* Rhode Island Agricultural Bank, 1 R. I. 376; Terry *v.* Little, 101 U. S. 216; Pollard *v.* Bailey, 20 Wall. (U. S.) 520.

respect of their individual or superadded statutory liability, equity is the proper forum, unless the language of the statute is such as to indicate the purpose on the part of the Legislature to give a remedy to any creditor against any stockholder distributively; and this is held to be so in many cases, even where there may be a *concurrent* remedy at law.[1] In this case legal theories frequently give away before considerations of practical convenience; and even where the individual liability is not in the nature of assets of the corporation, so that a receiver may not in right of the corporation, on strictly legal theories, sue for and recover assessments against the stockholders based on their superadded liability,—yet, as the statutes imposing this liability may well be held to create a common fund for the security of all the creditors, it is easy to adopt the conclusion that the preferable remedy is by a general creditors' bill in equity. Thus, it is held in Minnesota that the individual liability imposed on stockholders for corporate debts, by the constitution of that State, may be enforced in a sequestration proceeding under a statute,[2] which is the statutory equivalent of a general creditors' bill.[3] So, in Georgia it is allowed to creditors of insolvent banks to file a creditors' bill in equity, and, if the assets of the bank subjected to their demands are not sufficient to satisfy them, to make the decree recovered against the bank the basis of

[1] Queenan *v.* Palmer, 117 Ill. 619; Bank of United States *v.* Dallam, 4 Dana (Ky.), 574; *ante*, § 3416.

[2] Minn. Gen. Stats. 1878, ch. 76.

[3] Arthur *v.* Willius, 44 Minn. 409; McKusick *v.* Seymour, 48 Minn. 158; *s. c.* 50 N. W. Rep. 1114. See, especially, the discussion in McKusick *v.* Seymour, *supra*, for a statement of the reasons which have led to the adoption of this remedy; and note the following language of Mitchell, J.: "As rules of practice are but a means to an end, and ordinarily, as in this case, do not go to the merits of a controversy, such questions should not, as a general rule, occupy an extensive space in the decisions of courts of last resort; and if a rule is once established which works well in practice, the mere fact that it may be technically erroneous is not necessarily a sufficient reason for changing it by overruling former decisions." See, also, the analogous case of Spooner *v.* Bay St. Louis Syndicate, 47 Minn. 464; *s. c.* 50 N. W. Rep. 601; Hospes *v.* Northwestern Man. &c. Co., 48 Minn. 174; *s. c.* 31 Am. St. Rep. 637; 50 N. W. Rep. 1117.

further proceedings against the stockholders in respect of their individual liability.[1]

§ 3432. Reasons of the Doctrine That the Equity Forum Is Exclusive.—The reasons which support the view that the remedy in equity, even in respect of a statutory individual liability, is exclusive are numerous: 1. A resort to equity prevents a *multiplicity of suits.*[2] 2. Equity is the only tribunal capable of enforcing *contribution*[3] among shareholders, and thus, while satisfying creditors, equalizing the burdens of the contributories. 3. Equal *distribution* between creditors can be decreed by no other tribunal. 4. Besides, cases of this kind frequently involve conflicting equities growing out of the fact that some of the shareholders are themselves creditors of the corporation, or have unsettled demands against it; and these a court of law is incapable of adjusting. 5. Moreover, where modern codes have not changed the practice, a court of equity is the only tribunal capable of compelling a *discovery,*[4] by a defendant corporation, of the names of its stockholders, the amount of stock held by them respectively, and the extent of their respective liability.

§ 3433. Where the Proceeding Is to Enforce Contracts Made in Behalf of the Corporation Prior to Its Organization. It has been held that equity is the proper forum in which to proceed to get relief in respect to a contract made in behalf of the corporation, *by its promoters,* prior to its organization, unless there has been a subsequent *ratification* by the corporation, in which case the proceeding may be at law. "This," says the court, "will become a legal right if the corporation should affirm the contract or do any act from which an affirm-

[1] City Bank *v.* Crossland, 65 Ga. 734.

[2] Smith *v.* Huckabee, 53 Ala. 191.

[3] *Post,* § 3816, *et seq.* Compare § 3829, *post;* Murray *v.* Albert, 24 Md. 522; Erickson *v.* Nesmith, 46 N. H. 371; Hadley *v.* Russell, 40 N. H. 109; Masters *v.* Rossie Lead Mining Co., 2 Sandf. Ch. (N. Y.) 301; Thayer *v.* Union Tool Co., 4 Gray (Mass.), 75; Terry *v.* Little, 101 U. S. 216; Pollard *v.* Bailey, 20 Wall. (U. S.) 520.

[4] See Miers *v.* Zanesville Co., 11 Ohio, 273; Castleman *v.* Holmes, 4 J. J. Marsh. (Ky.) 1.

ance may be implied; but at law the general rule obtains that corporations cannot be bound by acts done or promises made in their behalf before they come into existence." The court also say that the doctrine "originated in equity and is still a subject of equity jurisdiction, although, in clear cases of ratification or adoption, it may now be enforced at law, especially in those States in which the separate courts of equity have been abolished."[1]

§ **3434. Remedy in Equity Where Statute Liability Is to Creditors as a Class.**—Where the statute is so framed as to make the liability of the stockholders a liability, not to separate creditors who may proceed against them, but to the creditors *as a class*, the remedy will be exclusively in equity, to the end that there may be an equal distribution among the creditors, and an equal assessment upon the stockholders. It was so held by the Supreme Court of the United States, under a statute of the District of Columbia enacting that "if the indebtedness of any company organized under this act shall at any time exceed the amount of its capital stock, the trustees of such company assenting thereto shall be personally and individually liable for such excess *to the creditors* of the company." Here it was held that the liability of the directors for "such excess" constituted a *trust fund*, for all the creditors, in so far as the condition of the company might render a resort to it necessary for the payment of its debts, and hence that an action at law could not be sustained by one creditor among many for the liability thus created, or for any part of it, but that the remedy was exclusively in equity.[2] Upon the reasoning of this case the Supreme Court of Illinois reached the same conclusion where the liability was created by section 16 of the statute of that State authorizing the formation of corporations for manufacturing, mining, mechanical, and chemical purposes,—reading as follows: "If the

[1] Perry *v.* Little Rock &c. R. Co., 44 Ark. 383, 394; *s. c.* on former appeal, 37 Ark. 164; *ante,* § 489.

[2] Hornor *v.* Henning, 93 U. S. 228, 232.

indebtednesss of any stock corporation exceed the amount of its capital stock, the directors and officers of such corporation assenting thereto shall be personally and individually liable for such excess to the creditors of such corporation."[1] The same court subsequently reached the same conclusion in a case arising under the ninth section of the same statute, which reads as follows: "All the stockholders of every such company shall be severally individually liable *to the creditors* of the company to an amount equal to the amount of stock held by them, respectively, for all debts and contracts made by such company prior to the time when the whole amount of its capital stock shall have been paid in, and a certificate thereof made and filed as hereinafter required."[2] The New York Court of Appeals have reached the same conclusion under a charter of a financial institution making its stockholders *severally* liable for its debts;[3] and, as elsewhere seen, the jurisdiction of equity is *exclusive*, under some theories, where the stockholder proceeded against is also a creditor.[4]

§ 3435. Or Where the Statute Creates a Common Fund for Creditors.—Stating the same doctrine in another way, where the effect of the statute is to create a *common fund* for the security of the creditors, a court of equity will have jurisdiction of a bill by a creditor, in behalf of himself and all the others who may choose to join, although there may be concurrent remedy at law;[5] and where in such a case it appears that the assets of the corporation and the superadded liability of all the solvent stockholders will not, when combined, form a fund sufficient to liquidate the debts, equity will *enjoin* the prosecution of suits at law by individual creditors, and thus prevent them from acquiring an advantage over

[1] Low *v.* Buchanan, 94 Ill. 76.

[2] Harper *v.* Union Man. Co., 100 Ill. 225, 230; reaffirmed in Rounds *v.* McCormick, 114 Ill. 252. And, in a case where the liability arose under a statute of Michigan. Young *v.* Farwell, 139 Ill. 326.

[3] Pfohl *v.* Simpson, 74 N. Y. 137.

[4] *Post*, § 3446.

[5] Queenan *v.* Palmer, 117 Ill. 619; Eames *v.* Doris, 102 Ill. 350; qualifying Wincock *v.* Turpin, 96 Ill. 135.

other creditors.[1] As to what species of statute imposing an individual liability upon stockholders operates to create such a *common fund*, it may be concluded that any statute, which does not in terms import a liability to the creditors *severally*, will have this effect. Such an effect was ascribed to the following statute, which it will be perceived is no more than the ordinary individual liability statute, with a qualification not relevant to the question under consideration: "That the stockholders of said corporation shall be responsible in their individual property in an amount equal to the amount of stock held by them, respectively, to make good all losses to depositors or others; and no assignment of their stock shall release them from such liabilities until after the fact of such an assignment, and name of the person to whom made, and the amount of the stock assigned, shall have been advertised in some public newspaper published in the city of Springfield, for the period of three months."[2]

§ 3436. Inapplicability of the Doctrine That Equity Will Not Relieve One Who Has a Remedy at Law. — The elemental rule of equity jurisprudence, that a court of this character will deny its aid to a suitor who has an adequate remedy at law, except in cases of concurrent jurisdiction, applies to this subject only so far as that these courts withhold their aid to a judgment creditor of a corporation, in respect of the liability of shareholders, when there are *legal assets* of the corporation within reach of his execution.[3] The general rule is, that, although a creditor has a *concurrent remedy* against a shareholder at law, this does not oust the jurisdiction of the courts of equity.[4]

[1] Eames *v.* Doris, *supra;* distinguishing Wincock *v.* Turpin, 96 Ill. 135, where the contrary was held, but in a bill which did not set out a state of facts such as stated in the text.

[2] Queenan *v.* Palmer, *supra.*

[3] Allen *v.* Montgomery R. Co., 11 Ala. 437; *ante,* § 3416.

[4] Bank of Poughkeepsie *v.* Ibbotson, 24 Wend. (N. Y.) 473, 479; Bank of United States *v.* Dallam, 4 Dana (Ky.), 574; Harmon *v.* Page, 62 Cal. 448; Baines *v.* Babcock, 95 Cal. 581; *s. c.* 29 Am. St. Rep. 158; Holmes *v.* Sherwood, 3 McCrary (U. S.), 405; *s. c.* 16 Fed. Rep. 725. In New Hamp-

§ 3437. **Grounds on Which Concurrent Jurisdiction in Equity Supported.** — But in view of the fact that these courts alone have adequate power to enforce a ratable *contribution* and distribution,[1] and that the proceeding, on the ground of *trust*, to subject in the hands of stockholders that portion of the capital stock which they withheld from the company is exclusively a subject of equity cognizance;[2] or that the aid of equity may be needed to *discover* assets of the corporation,[3] —these courts will take jurisdiction and proceed to do complete justice in a single proceeding,[4] thereby preventing a *multiplicity of suits.*[5]

§ 3438. **On the Ground of Discovery.** — Moreover, as the members of corporations are in general unknown to the public, and are constantly changing by reason of transfers, there is great propriety in maintaining the jurisdiction of equity on the ground of *discovery*, notwithstanding the statute gives a concurrent remedy at law.[6] This is one of the grounds on which equity assumes jurisdiction to aid creditors of corporations against shareholders. Hence, a creditor may maintain a suit against stockholders having in their possession the assets of the corporation, and may, as against the corporation, seek a *discovery* of the names of stockholders whose names are fraudulently concealed from him.[7] And where the stockholders are, by the governing statute, liable for the

shire a creditor of a corporation is not bound to exhaust his legal remedies before seeking to enforce in equity the individual liability of the stockholders imposed by statute. Nor is he bound to exhaust his remedies against sureties. Connecticut River Savings Bank *v.* Fiske, 60 N. H. 363.

[1] Atwood *v.* Rhode Island Bank, 1 R. I. 376; Pollard *v.* Bailey, 20 Wall. (U. S.) 520; Terry *v.* Little, 101 U. S. 216.

[2] *Ante*, § 2951, *et seq.*

[3] *Post*, § 3438.

[4] Robison *v.* Carey, 8 Ga. 527; Bank of United States *v.* Dallam, 4 Dana (Ky.), 574; Castleman *v.* Holmes, 4 J. J. Marsh. (Ky.) 1. Where the charter permitted creditors to sue the stockholders in any court having cognizance thereof, it was held that a suit might be commenced in equity. Masters *v.* Rossie Lead Mining Co., 2 Sandf. Ch. (N. Y.) 301.

[5] Smith *v.* Huckabee, 53 Ala. 191, 195

[6] Castleman *v.* Holmes, 4 J. J. Marsh. (Ky.) 1; Bogardus *v.* Rosendale Man. Co., 7 N. Y. 147.

[7] Brewer *v.* Michigan Salt Asso., 58 Mich. 351; Masters *v.* Rossie Lead Mining Co., 2 Sandf. Ch. (N. Y.) 301.

debt of the corporation to the extent of what remains unpaid on their shares of capital stock, or of such proportion thereof as may be necessary to satisfy the same, a judgment creditor of the corporation, whose execution has been returned unsatisfied, may compel a discovery of the *names* of such stockholders, by a bill in equity, and the *amounts unpaid* on their shares.[1] So, a bill for discovery by the creditors of a corporation against the individual members made *liable by statute* for the debts of the corporation, in a case not otherwise exceptionable, may be sustained.[2] So, a bill setting forth that a great number of individuals, whose names are unknown, but whom, when discovered, the complainants ask to be made parties, are indebted upon subscriptions for stock, and praying that the company may set forth their names in its answer, cannot be demurred to on the ground that it is a fishing bill, and wanting in sufficient certainty. When the liability of the defendant corporation is fixed, and no assets at law are forthcoming, the proper practice is to compel *it* to disclose its means to pay the debt, especially where the nature of the resources for this purpose are pointed out in the bill, and its answers on this point are specifically required.[3] After the complainant in such a bill has obtained such a discovery of the shareholders chargeable on behalf of the creditors, he may *amend* his bill and make them parties, for the purpose of charging them personally with the deficiency to the extent of their liability;[4] or he may wait until a final decree against the corporation has been made, and its effects have been distributed among the creditors, and may then file a *supplemental bill* for the purpose of charging them personally for the deficiency, to the extent of their statutory liability.[5]

[1] Morgan *v.* New York &c. R. Co., 10 Paige (N. Y.), 290 (1843); *s. c.* 40 Am. Dec. 244; followed in Bogardus *v.* Rosendale &c. Co., 7 N. Y. 147.

[2] Middletown Bank *v.* Russ, 3 Conn. 135; *s. c.* 8 Am. Dec. 164; Bogardus *v.* Rosendale &c. Co., 7 N. Y. 147.

[3] Miers *v.* Zanesville &c. Co., 11 Ohio, 273.

[4] Morgan *v.* New York &c. Co., 10 Paige (N. Y.), 290; *s. c.* 40 Am. Dec. 244; followed in Bogardus *v.* Rosendale &c. Co., 7 N. Y. 147.

[5] Morgan *v.* New York &c. R. Co., 10 Paige (N. Y.), 290; *s. c.* 40 Am.

§ 3439. Bill by a Foreign Corporation to Discover Domestic Stockholders. — In Massachusetts, a corporation organized under the laws of another State may maintain a bill in equity against the officers of a debtor corporation for discovery of the names of its stockholders and of the number of shares held by each, if the officers reside in Massachusetts, and the books are kept there, in order, by a suit in the other State, to enforce a personal liability on such stockholders.[1] It is, however, conceded that the courts of Massachusetts will decline to exercise jurisdiction over a proceeding to enforce the liabilities of the stockholders of a foreign corporation,[2] although the contrary was held in Pennsylvania.[3]

§ 3440. Where the Liability Is in Proportion to the Stock Held. — From the nature of this liability,[4] it is to be inferred that the appropriate proceeding to enforce it would be to ascertain, by the taking of an account, the total amount of the indebtedness of the corporation; then to determine who are liable to contribute as shareholders, and what is each shareholder's fractional portion of this whole capital stock. This would determine the amount which he should be called upon to contribute to the payment of the corporate debts. A proceeding of this kind resembles strictly the administration of an insolvent estate, and obviously refers itself to a court of equity; and it is difficult to understand how a court of law could do

Dec. 244; Masters *v.* Rossie Lead Mining Co., 2 Sandf. Ch. (N. Y.) 301. Further as to the *practice in respect of bills of discovery*, see *post*, ch. 181.

[1] Post *v.* Toledo &c. R. Co., 144 Mass. 341; *s. c.* 59 Am. Rep. 86. That bills for discovery in aid of actions in foreign tribunals will be sustained, see Mitchell *v.* Smith, 1 Paige (N. Y.), 287; Burgess *v.* Smith, 2 Barb. Ch. (N. Y.) 276. Compare Bent *v.* Young, 9 Sim. 180; Reiner *v.* Salisbury, 2 Ch. Div. 378.

[2] Erickson *v.* Nesmith, 15 Gray (Mass.), 221; *s. c.* 4 Allen (Mass.), 233; Halsey *v.* McLean, 12 Allen (Mass.), 438; *s. c.* 90 Am. Dec. 157; New Haven Horse Nail Co. *v.* Linden Spring Co., 142 Mass. 349. See, also, Smith *v.* Mutual &c. Ins. Co., 14 Allen (Mass.), 336; *ante*, § 3058.

[3] Aultman's Appeal, 98 Pa. St. 505. See *ante*, § 3060, *et seq.*

[4] *Ante*, § 3001.

complete justice in such a case. Accordingly, the Supreme Court of the United States has held that where, by the charter of a bank, stockholders are "bound respectively for all the debts of the bank *in proportion* to their stock held therein," one creditor cannot sue a stockholder at law (there being numerous other creditors) to recover the full amount of his debt. This is especially so if the charter provides for a proceeding in chancery for the winding up of the bank, and a ratable distribution of its assets.[1] On the other hand, it has been held, under certain Georgia bank charters, which made each stockholder liable to redeem his proportionate share of the outstanding circulation, that single billholders might proceed against single stockholders *at law*.[2] There is less difficulty than in ordinary cases in sustaining an action at law under such a statute or charter, brought by a *billholder* of a bank, because the total outstanding circulation of the bank is, in the absence of gross fraud on the part of its management, capable of being easily ascertained without calling upon all the billholders to come in and prove up their claims before a master. With reference to the *form* of action, we find that in early cases in Georgia the action was *debt;* but this was doubtless controlled by the peculiar phraseology of the charter, making the stockholders liable to the billholders "as in common actions of debt."[3] In a later case the declaration was in *assumpsit;* but no question was made as to the form of action.[4]

§ **3441. In Case of Deceased Shareholders.**—Where the liability of the shareholder is akin to that of a *partner*, the remedy of a creditor against the *estate of a deceased shareholder*, as against that of a deceased partner, is *exclusively in*

[1] Pollard *v.* Bailey, 20 Wall. (U. S.) 520, 524.

[2] Lane *v.* Morris, 8 Ga. 468; Lane *v.* Harris, 16 Ga. 217; Branch *v.* Baker, 53 Ga. 502; Hatch *v.* Borroughs, 1 Woods (U. S.), 439.

[3] Lane *v.* Morris, 8 Ga. 468; Lane *v.* Harris, 16 Ga. 217.

[4] Branch *v.* Baker, 53 Ga. 502.

equity,[1] unless it is drawn into the *probate court* under particular statutory systems.[2]

§ **3442. When Court Will Not Restrain Proceedings at Law.** — Where the stockholders are jointly and severally liable, but only for those debts which were contracted while they were shareholders,[3] so that all the creditors cannot conveniently join in a single suit in equity,[4] a court of chancery will not, upon a summary application, either before or after decree, restrain proceedings at law against the stockholders of such a corporation, or any of them, by creditors of the corporation who were not parties to the suit in equity.[5] In Illinois the charter of a savings bank declared that all the stockholders should be severally and individually liable to the depositors to the amount of stock held by them respectively. The bank failed, and a receiver was appointed. Suits at law were brought by individual depositors against individual stockholders, to enforce the liability created by the charter. The receiver brought a suit (one creditor joining) in equity to enjoin these suits, and to enforce, as such receiver, the liability of the stockholders, for the benefit of all concerned. It was held that the depositors could not be deprived of their right to sue at law.[6] Subsequently this holding was in effect *overruled*, though nominally *qualified*, the court holding that where it appears that the assets of the corporation and the superadded liability of all the solvent stockholders will not, when combined, form a *fund* sufficient to liquidate its debts, equity will enjoin the prosecution of actions at law by individual creditors, against individual stockholders, and thus prevent them from acquiring an advantage over other creditors.[7]

[1] New England Commercial Bank *v.* Newport Steam Factory, 6 R. I. 154, 190; *s. c.* 75 Am. Dec. 688, where the subject is fully considered by Chief Justice Ames. See *ante*, § 3327, *et seq.*

[2] *Ante*, § 3317, *et seq.*

[3] *Ante*, § 3173.

[4] But see *post*, § 3483. The fact that the creditors might stand in *different classes* would present no obstacle to such a court: though equity would be the proper forum where all belonged to *one class*. *Ante*, § 3434.

[5] Judson *v.* Rossie Galena Co., 9 Paige (N. Y.), 598 (1842); *s. c.* 38 Am. Dec. 569.

[6] Wincock *v.* Turpin, 96 Ill. 135; Scott and Sheldon, JJ., dissented.

[7] Eames *v.* Doris, 102 Ill. 350.

Article III. Where the Creditor Is Also a Stockholder.

Section
3446. Remedy exclusively in equity.
3447. Rule not applicable where creditor stockholder has satisfied his own liability.
3448. Whether assignee of a stockholder may sue at law.
3449. Cases disaffirming or qualifying the rules.
3450. Circumstances estopping the stockholder from maintaining any kind of action.

§ **3446. Remedy Exclusively in Equity.** — If the creditor is also a stockholder, his right to maintain an action at law may turn upon the view taken by the court of the nature of the stockholder's liability in the particular case. We have already had occasion to consider statutes and charters under which the liability of stockholders is held to resemble that of *partners;*[1] and such is the liability ascribed to them in many cases, where debts have been contracted in the name of the corporation before it has become incorporate, or before certain conditions precedent have been complied with.[2] Now, it is settled that one partner cannot maintain an action at law against his copartners for a debt due from the firm.[3] By analogy to this rule, it has been held that a creditor who is a stockholder cannot maintain an action at law for the recovery of his debt against his co-shareholders;[4] nor, according to one view, can a creditor maintain an action at law,

[1] *Ante*, § 3072, *et seq.*

[2] *Ante*, § 2969, *et seq.*

[3] Milburn *v.* Codd, 7 Barn. & C. 419; Holmes *v.* Higgins, 1 Barn. & C. 74; Causton *v.* Burke, 2 Har. & G. (Md.) 295; *s. c.* 18 Am. Dec. 297; Neale *v.* Turton, 4 Bing. 149; Chadwick *v.* Clarke, 1 Com. B. 700; Estes *v.* Whipple, 12 Vt. 373; Bracken *v.* Kennedy, 4 Ill. 558; Banks *v.* Mitchell, 8 Yerg. (Tenn.) 111; *s. c.* 29 Am. Dec. 106; Myrick *v.* Dame, 9 Cush. (Mass.) 248; Hall *v.* Logan, 34 Pa. St. 331; McFadden *v.* Hunt, 5 Watts & S. (Pa.) 468; Collamer *v.* Foster, 26 Vt. 754.

[4] Bailey *v.* Bancker, 3 Hill (N. Y.), 188; *s. c.* 38 Am. Dec. 625; Beers *v.* Waterbury, 8 Bosw. (N. Y.) 396; Richardson *v.* Abendroth, 43 Barb. (N. Y.) 162; Wait *v.* Ferguson, 14 Abb. Pr. (N. Y.) 379; Deming *v.* Pulleston, 33 N. Y. Super. Ct. 235; Clark *v.* Myers, 11 Hun (N. Y.), 609; Thayer *v.* Union Tool Co., 4 Gray (Mass.), 75; Potter *v.* Stevens Machine Co., 127 Mass. 592; *s. c.* 34 Am. Rep. 428. *Contra*, Simonson *v.* Spencer, 15 Wend. (N. Y.) 548; Fowler *v.* Robinson, 31 Me. 189. Compare Remington *v.* King, 11 Abb. Pr. (N. Y.) 278.

even under a statute of individual liability, against a stockholder who is himself a creditor.[1] So, in Massachusetts, a creditor who is also a stockholder, and as such individually liable for the debts of the corporation, cannot take the property of other stockholders equally so liable under a statute making the members of a manufacturing corporation jointly and severally liable for debts contracted before its capital is paid in, and giving a remedy by attachment or execution against their property; but such a creditor must resort to his bill in equity against his co-stockholder for contribution. The reason is said to be that such a stockholder is not a person having a *debt*[2] against the company which, as respects him and as to him, the other stockholders are jointly and severally liable to pay: their ultimate liability to him is only to pay their *proportionate share* of the debt;[3] therefore his only right against them is the right to a *contribution*, to secure which equity is the only competent forum.[4] So, the provision of the New York Manufacturing Act,[5] that all stockholders shall be liable *to creditors* until the entire capital stock shall have been paid in, does not include *directors* to whom the corporation is indebted for their salaries.[6]

§ **3447. Rule Not Applicable Where Creditor-stockholder Has Satisfied His Own Liability.** — Manifestly the foregoing rule can have no proper application to a case where the creditor-stockholder, before bringing the action against his co-stockholder, has completely paid up and satisfied all that he himself as a stockholder is liable to pay. His own liability as a stockholder thus completely discharged, no question of contribution can arise between him and his co-stockholders; for he cannot, under any circumstances, be called upon to contribute more; and hence he stands, on principle, in respect of his right of

[1] Mathez *v.* Neidig, 72 N. Y. 100.

[2] See *ante*, § 3125.

[3] Thayer *v.* Union Tool Co., 4 Gray (Mass.), 75; reaffirmed in Potter *v.* Stevens Machine Co., 127 Mass. 592; *s. c.* 34 Am. Rep. 428. Compare Merchants' Bank *v.* Stevenson, 5 Allen (Mass.), 398.

[4] Thayer *v.* Union Tool Co., *supra*.

[5] N. Y. Laws 1848, ch. 40, § 10.

[6] McDowall *v.* Sheehan, 129 N. Y. 200; *s. c.* 29 N. E. Rep. 299.

action against them, on the footing of any creditor who is not a stockholder. A better statement of the rule therefore is that which is found in some of the cases, namely, that a stockholder *cannot maintain an action*, or a *motion* for an execution, against another stockholder in the same corporation, *without first having paid up and exhausted his own liability as a stockholder.*[1]

§ 3448. Whether Assignee of a Stockholder May Sue at Law. — It seems that a third person, to whom a debt owing by a corporation to one of its stockholders has been assigned in good faith, may sue a stockholder at law, provided that remedy is open to any other creditor at large.[2] But a person to whom notes of the corporation held by one of its stockholders have been assigned, for the sole purpose of enabling him, the assignor, to evade this rule, by having the assignee conduct proceedings, in his own name, for the benefit of the assignor, with an agreement to secure the assignee against any personal responsibility for costs and expenses and to pay him for his services, cannot (in Massachusetts) maintain a suit in equity to enforce the individual liability of another stockholder. Such an assignee stands in the shoes of his assignor and can have no larger remedy against other stockholders than he could have.[3]

[1] See Franklin *v.* Menown, 10 Mo. App. 570, where the rule is stated substantially in this way.

[2] Woodruff & Beach Iron Works *v.* Chittenden, 4 Bosw. (N. Y.) 406.

[3] Potter *v.* Stevens Machine Co., 127 Mass. 592; *s. c.* 34 Am. Rep. 428. In a case in New York a stockholder held a note of the company, payable to B. and indorsed by him. Upon this note he recovered judgment against the company, and, his execution being returned *nulla bona*, he sued the indorser and recovered judgment against him. He then assigned his judgment against the company to the indorser, who commenced a suit thereon for his own benefit against another stockholder. It was held that this action could not be maintained. There ought not to have been a recovery against the indorser. When he was sued he should have answered: "You cannot recover from me a sum of money which I can immediately recall in an action brought against you as a stockholder of the company." Bailey *v.* Bancker, 3 Hill (N. Y.), 188; *s. c.* 38 Am. Dec. 625.

§ 3449. Cases Disaffirming or Qualifying the Rule. — Several cases exist which, proceeding more or less in deference to statutes, either disaffirm or materially qualify the foregoing rule. The Supreme Court of Pennsylvania has felt obliged, in obedience to the supposed meaning of a statute of that State,[1] to establish the rule that a stockholder who is also a creditor may sue his co-stockholders at law, joining with them the corporation, even where he has been compelled to pay a debt of the corporation, and his object is to enforce contribution.[2] The Supreme Court of South Carolina perceived no difficulty in holding, under a statute declaring that "each stockholder in the said corporation shall be jointly and severally liable to the creditors thereof, in an amount, besides the value of his share or shares therein, not exceeding ten per cent of the par value of the share or shares held by him at the time the demand of the creditor was created," — that the liability was one which might be enforced by an action *at law* by a single creditor against a single stockholder;[3] and also that it made no difference that the creditor bringing the action was himself a stockholder, or even a director. Upon the last question the court did not see how a doubt could be entertained. Mr. Justice McIver, who gave the opinion of the court, said, referring to a number of decisions holding that an officer or agent of a corporation may become its creditor:[4] "The provision in the charter is in favor of all creditors without distinction; and therefore if an officer or agent of a corporation is capable of becoming its creditor, we see no reason why the plaintiffs may not avail themselves of this provision of the charter, even though they may have been officers or agents of the company."[5] On some such ground,

[1] Brightly's Purd. Dig. 998, § 30.

[2] Brinham *v.* Wellersburg Coal Co., 47 Pa. St. 43.

[3] *Ante*, §§ 3087, 3088.

[4] *Post*, § 4059, *et seq.*

[5] Hall *v.* Klinck, 25 S. C. 348, 357; *s. c.* 60 Am. Rep. 505. The debt which was the foundation of the action in this case had been incurred by the corporation in favor of a *partnership firm*, all of whose members were stockholders in the corporation, and one of them its president and another a director; and the court seemed to suppose that the partnership firm, for the purposes of the

the right of a creditor, who was himself a shareholder in the corporation, to move for an execution under a statute against another shareholder, was sustained in a case in Missouri.[1]

§ 3450. Circumstances Estopping the Stockholder From Maintaining Any Kind of Action. — Outside of the foregoing principles, circumstances may exist creating an estoppel against the creditor stockholder from maintaining any kind of action, legal or equitable, to enforce his demand against other stockholders. Thus, one who is a creditor of a corporation, and at the same time one of its trustees, cannot maintain an action against a co-trustee to recover from him a debt due from the company, under a statute making all the trustees of the company jointly and severally liable for its debts contracted during the period of a neglect on the part of its trustees to make an annual and prescribed report of its financial condition; nor does such a delinquent trustee have any right of *contribution* against his co-trustees,— and all this for the reason that the law will not allow him to make his own violation of the statute the foundation of an action against others who are not more guilty than himself.[2] So, where one of the trustees of a company concurred in the passing of a resolution providing that, upon the payment of the assessments which were in arrears, "there should be no further demands made by prosecution against any subscriber upon his subscription, nor any proceedings be had against any subscriber other than by way of forfeiture of his said stock, in case of his non-pay-

question under consideration, was to be deemed in law a distinct person, different from the individuals composing it, with different rights, privileges, and liabilities, and must not be confounded with them, — a view which, it is submitted, is wholly untenable. See, for an example to the contrary, Bank of Fort Madison *v.* Alden, 129 U. S. 372, where an incorporated bank was held estopped by the acts of its sole shareholders, who were shareholders in another corporation; and yet a corporation is a different person in law from its shareholders collectively, when acting in their individual capacities. *Ante.* § 16, *et seq.* It should be added, however, that, under the facts of the South Carolina case, it does not appear that any question of contribution could arise.

[1] Schaeffer *v.* Phœnix Brewery Co., 4 Mo. App. 115, 120.

[2] Andrews *v.* Murray, 33 Barb. (N. Y) 354; *post,* §§ 3823, 4376.

ment of any further calls,"—this precluded him from maintaining an action in equity, as a creditor of the corporation, against a subscriber who had complied with the resolution. "Those resolutions," said Chancellor Kent, "were a compact between the representative and the constituent, between the trustees and the stockholders; and the plaintiff, as a party thereto, is bound in good faith to observe them. . . . He cannot be permitted, in this case, to discriminate between his rights as a creditor and his acts as a trustee. There would be a mistaken casuistry in the distinction; and one which a court of equity could not recognize. It would have the color and effect of imposition and fraud."[1] So, a stockholder who had participated in the illegal and fraudulent organization of a bank, upon a spurious basis, and not on a specie basis, as required by its charter, could not maintain an action against another stockholder upon dishonored bills of the bank, under a clause of the charter making the stockholders individually liable for its circulating notes; and evidence was consequently admissible, on the part of the defendant in such an action, to show the fraudulent manner in which the bank had been put into operation.[2] A case in Massachusetts was decided partly upon like grounds. A. had made a contract with B. for the purchase of a number of shares, and had paid part of the agreed price, but the shares were not then transferred to him. While they still stood in the name of B. on the books of the corporation, A. attended meetings of the stockholders, and voted as such. At one of these meetings a vote was passed to divide the cash assets of the company among the stockholders. A. voted in the affirmative. Afterwards, upon a settlement between A. and B., the shares were formally transferred to him, and he was credited with dividends received thereon, including that accruing from the withdrawal by the stockholders of the cash assets of the company. Afterwards, A. brought an action against the corporation for a debt due from it to him, recovered judgment, and, the corporation neglecting

[1] Slee *v.* Bloom, 5 Johns. Ch. (N. Y) 366, 382, 383.

[2] Robinson *v.* Lane, 19 Ga. 337.

to pay the judgment for thirty days after a demand upon it, A. brought a suit in equity under a statute,[1] to enforce the personal liability of the stockholders, on the ground of the withdrawal of the capital stock while there were debts outstanding. Aside from the difficulty of allowing one stockholder to maintain an action against the others, in opposition to the settled rule in Massachusetts,[2] it was held that the plaintiff could not make the very act which he, as a stockholder, took a part in bringing about, and of which he had reaped the benefit, a ground for charging other stockholders with the personal liability prescribed by the statute.[3] On like grounds, and quoting the last-named case, the Supreme Court of the United States have held that where an incorporated lumber company held a large quantity of lands heavily mortgaged, which it had received from its several stockholders in payment of their share subscriptions, and had, in pursuance of an arrangement among all stockholders, reconveyed the several tracts to the stockholders from whom they had been received, — a creditor of the company consisting of an incorporated joint-stock bank, having but two stockholders, who were also stockholders in the lumber company, and who had participated in this arrangement and received a reconveyance of the land which they had conveyed to the company, — could not maintain a suit in equity to charge other shareholders, on the ground of their having unlawfully taken into their possession property which constituted a trust fund for the payment of creditors.[4]

ARTICLE IV. RULES IN PARTICULAR JURISDICTIONS.

SECTION
3453. Rule in the United States courts.
3454. Alabama.
3455. California.
3456. Colorado.
3457. Connecticut.
3458. Florida.
3459. Georgia.
3460. Illinois.
3461. Indiana.
3462. Iowa.
3463. Kansas.

[1] Mass. Stat. of 1870, ch. 224, § 42.

[2] *Ante*, § 3446.

[3] Thompson *v.* Bemis Paper Co., 127 Mass. 595.

[4] Bank of Fort Madison *v.* Alden, 129 U. S. 372.

SECTION
3464. Maine.
3465. Maryland.
3466. Massachusetts.
3467. Minnesota.
3468. Missouri.
3469. New York.
3470. Ohio.
3471. Oregon.
3472. Pennsylvania.
3473. Rhode Island.
3474. South Carolina.
3475. Washington.
3476. Wisconsin.

§ **3453. Rule in the United States Courts.** — Considering that the subject is one which depends on the interpretation of the charter or governing statute,[1] and that the rule in the national courts is, that where a statute of a State, being a rule of property, has received an interpretation at the hands of the courts of that State, such interpretation will be followed and applied in the courts of the United States,[2] we find that it has been held by the Supreme Court of the United States that where the statute of a State, as construed by the highest judicial tribunal in that State, authorizes an action of debt against the stockholder, by a creditor of the corporation, that remedy may be pursued in a court of the United States.[3] Where the statute has not received judicial interpretation in the courts of the particular State, the Federal court must, of course, supply its own interpretation, as was done by Mr. Justice Story at circuit where he ruled that under a statute making stockholders personally liable for the debts of the corporation, an action of *debt* would lie against the stockholder by a creditor of the corporation.[4] Speaking generally, and with reference to a superadded individual liability which does not exist except by statute, the question whether the remedy in the Federal courts should be by an action at law or by a suit in equity, depends upon the nature of the remedy given by the statutes of the State.[5] So, in a proceeding to

[1] *Ante*, §§ 1137, 3046.

[2] Flash *v.* Conn, 109 U. S. 371; Chase *v.* Curtis, 113 U. S. 452; Hawkins *v.* Glenn, 131 U. S. 319, 331; Canada Southern R. Co. *v.* Gebhard, 109 U. S. 527; Morgan County *v.* Allen, 103 U. S. 498.

[3] Mills *v.* Scott, 99 U. S. 25. To the same effect is Borland *v.* Haven, 37 Fed. Rep. 394, 405.

[4] Bullard *v.* Bell., 1 Mason (U. S.), 243.

[5] Fourth Nat. Bank *v.* Francklyn, 120 U. S. 747, 756; Mills *v.* Scott, 99

enforce the liability of a stockholder created by the statute of a State, the courts of the United States give to a *judgment* of the State court, obtained by the creditor against the corporation, the same *effect*, either as *evidence* or as the foundation of the action, which is given to it in like proceedings of the courts of the States whose laws are invoked by the creditor.[1] Again, where a statute of a State creates a right on the part of creditors of a corporation to proceed against its shareholders, and prescribes a remedy for the assertion of that right, then, in conformity with a general rule of statutory construction, that remedy is exclusive; and following this principle, that is the only remedy which can be applied in a court of the United States.[2] On the other hand, that remedy can be applied in a court of the United States, where the citizenship of the parties is such as to give the jurisdiction, whenever it could be applied in the courts of the State conferring it.[3] In one case it was said by an experienced Federal judge at circuit that "matters of this kind are cognizable in equity, and only in equity, unless there is some statutory proceeding with respect thereto."[4]

§ 3454. Alabama.—In Alabama the rule which remits this subject to the forum of equity was so much favored that it was held

U. S. 25; Terry *v.* Little, 101 U. S. 216; Patterson *v.* Lynde, 106 U. S. 519; Flash *v.* Conn, 109 U. S. 371; Borland *v.* Haven, 37 Fed. Rep. 394, 405. See also Blair *v.* Gray, 104 U. S. 769.

[1] Chase *v.* Curtis, 113 U. S. 452.

[2] Pollard *v.* Bailey, 20 Wall. (U. S.) 520, 526; Fourth Nat. Bank *v.* Francklyn, 120 U. S. 747, 756.

[3] Borland *v.* Haven, 37 Fed. Rep. 394, 405. The case of Ellis *v.* Davis, 109 U. S. 485, is instructive upon this question of the applicability, in the courts of the United States, of remedies given by State statutes. The court held that, in general, the courts of the United States have no jurisdiction for annulling or affirming the probate of a will: following Broderick's Will, 21 Wall. (U. S.) 503. But the court at the same time held that if, by a law obtaining in a State, a suit whose object is to annul and set aside the probate of a will divesting real estate can be maintained, it can be maintained in a court of the United States, when the parties on the one side are citizens of the State in which the will is procured, and on the other citizens of other States: following Gaines *v.* Fuentes, 92 U. S. 10, 18.

[4] Brown *v.* Fisk, 23 Fed. Rep. 228, opinion by Treat, J.

that a statute giving the creditor a remedy against the stockholder by *garnishment*, in repect of what was due by the latter on his subscription, was *prospective* only.[1] According to a principle elsewhere explained,[2] the statute was so applied that, when stockholders were *in default after calls regularly made*, a judgment creditor was deemed to have a complete remedy at law by process of *garnishment*, and hence could not proceed in equity. But as to such stockholders who were not in default to the corporation, by reason of no call having been made, but whose subscriptions to the capital stock had not been paid, a court of equity had jurisdiction to compel payment at the instance of an execution creditor of the corporation.[3] An action at law did not lie against a stockholder of a manufacturing corporation, formed under the provisions of the Revised Code of Alabama, to enforce the liability of stockholders prescribed by the following section: "The stockholders of any such corporation are liable for all debts due by it, at the time of its dissolution, to the extent of their stock";[4] the remedy was in equity only.[5] Although this statute is a copy, with some unimportant variations, of a statute of New York, the Supreme Court of Alabama decline to follow the rulings of the courts of that State, in so far as they hold that an action at law may be maintained by individual creditors against individual stockholders.[6]

§ 3455. California. — In this State, as already seen,[7] the statutory liability of a stockholder is that of *an original undertaker;* and it would seem to follow that the creditor may proceed by a direct action at law, as in New York. Under the act of that State of April 22, 1866, declaring each stockholder of a life insurance company individually liable for such proportion of its debts as the amount of his stock bears to the whole stock, a creditor, before the

[1] Bingham *v.* Rushing, 5 Ala. 403; De Mony *v.* Johnston, 7 Ala. 51.

[2] *Post*, § 3578.

[3] Allen *v.* Montgomery R. Co., 11 Ala. 437.

[4] Ala. Rev. Code, § 1760; Ala. Code of 1852, § 1478.

[5] Smith *v.* Huckabee, 53 Ala. 191.

[6] Spence *v.* Shapard, 57 Ala. 598. A like conclusion was reached by the Supreme Court of the United States under a bank charter granted by the Legislature of Alabama, prescribing a remedy in equity, — that court, without referring to the decisions of the Alabama court above cited, holding that the statutory remedy was *exclusive*, under the principle considered in a previous section. Pollard *v.* Bailey, 20 Wall. (U. S.) 520; *ante*, § 3414.

[7] *Ante*, § 3077.

adoption of the new constitution, could sue a stockholder at law for his proportion of a debt, and this without first suing the company.[1] The applicatory statute of California provides that "any creditor of the corporation may institute joint or several actions against any of its stockholders for the proportion of his claim, payable by each, and in such action the court must ascertain the proportion of the claim or debt for which each defendant is liable, and a several judgment must be rendered against each in conformity therewith."[2] This section is held to prescribe an *action at law;* so that, in a court of the United States, which in these cases follows the remedy prescribed by the applicatory State statute,[3] the action will be an action at law.[4] But it is obvious from its language that it gives to the creditor his *election to proceed at law or in equity;* and it is accordingly held that when he has exhausted his legal remedies against the corporation, he may maintain a *creditor's bill in equity* against one or more stockholders to recover the amount due in respect of their unpaid subscriptions.[5] The statute above quoted[6] was not intended to take away from the creditor the right to resort to a court of equity which previously existed, but was intended to give him an additional remedy.[7] He may, therefore, proceed in equity for the benefit of himself and all other creditors who may choose to come in and be made parties.[8] He should make the corporation a *party;* but this is not indispensable, unless the object of the action is to secure an adjudication of the rights and liabilities of all the parties and a final settlement of the affairs of the company. In other words, the corporation is not an indispensable party unless the creditor brings his action in the form of a general winding-up bill.[9] This is in conformity with a previous holding in the same State, where it was reasoned that when a stockholder has contracted with a corporation to pay into the funds of the corporation a certain amount in respect of the capital stock for which he has subscribed, he is bound by such contract, and that a court of equity has jurisdiction, concurrently with the remedies afforded by statute, to enforce this

[1] Morrow *v.* San Francisco Superior Court, 64 Cal. 383.

[2] Cal. Civil Code, § 322.

[3] *Ante,* § 3453.

[4] Borland *v.* Haven, 37 Fed. Rep. 394, 405.

[5] Potter *v.* Dear, 95 Cal. 578; *s. c.* 30 Pac. Rep. 777; Baines *v.* Babcock, 95 Cal. 581; *s. c.* 29 Am. St. Rep. 158; 30 Pac. Rep. 776; 10 Rail. & Corp. L. J. 375; Babcock *v.* Story (Cal.), 30 Pac. Rep. 777.

[6] Cal. Civil Code, § 322.

[7] Baines *v.* Babcock, *supra.*

[8] *Ibid.*

[9] Potter *v.* Dear, *supra.*

liability for the benefit of creditors of the corporation, when it becomes insolvent.[1]

§ **3456. Colorado.**—In Colorado, the question is governed by the following statute: "If any corporation, or its authorized agent, shall do any act which shall subject to a forfeiture of its charter or corporate powers, or shall allow any execution or decree of any court of record for a payment of money, after demand made by the officer, to be returned 'no property found,' or to remain unsatisfied for ten days after such demand, or shall dissolve or cease doing business, leaving debts unpaid, suits in equity may be brought against all persons who were stockholders at the time, or liable in any way for the debts of the corporation, by joining the corporation in such suit, and each stockholder may be required to pay such debts or liabilities to the extent of the unpaid portion of his stock."[2] Where the contention was that, the common-law and equitable remedies having been blended under a code, it was unnecessary for the creditor to resort to a suit in equity, the court replied: "This section expressly recognizes and preserves in substance the equitable remedy existing, where the common-law procedure prevails, for cases wherein no proper assessment has been made in accordance with the statute. We are of the opinion that this remedy should be given the same exclusive force as pertains to the similar suit in common-law jurisdictions which it supplanted." It was accordingly held that the creditor had no remedy by *garnishment*, except to subject what might be due where a *call* had been made by the directors, to which the stockholders had not responded;[3] but that the remedy of the creditor to subject any unpaid balances due by the stockholder, which had not been called for by the directors, was exclusively in equity.[4] Under a statute of this State[5] a corporation and its stockholders may be joined as defendants in an action by a creditor of the corporation, where the corporation has ceased to do business and suffered a *de facto* dissolution,[6] leaving debts unpaid.[7]

[1] Harmon *v.* Page, 62 Cal. 448; *s. c.* 9 Am. Corp. Cas. 29. It is held that neither the provisions of the constitution of California of 1863, art. 4, §§ 32, 36, nor those of the constitution of 1869, art. 12, §§ 2, 3, nor that of the Civil Code, § 322, oust a court of equity of this jurisdiction. *Ibid.*

[2] Mills Ann. Stats. Col., § 497.

[3] As to which, see *post*, § 3578.

[4] Universal Fire Ins. Co. *v.* Tabor, 16 Col. 531, 534; *s. c.* 27 Pac. Rep. 890.

[5] Gen. Laws Col. 1877, § 212.

[6] As to this kind of a dissolution, see *ante*, § 3345, &c.; *post*, ch. 153.

[7] Tabor *v.* Goss &c. Co., 11 Col. 419.

§ **3457. Connecticut.** — In this State, where an act of incorporation provided that the persons and property of the members of the corporation should at all times be liable for all debts due by said corporation, it was held that the members were liable in an original manner, as if no incorporation existed, and therefore no *scire facias* could be maintained against them on a judgment against the corporation.[1]

§ **3458. Florida.** — Prior to the enactment of the Florida statute of May 31, 1877,[2] and under the operation of a pre-existing statute,[3] creating a statutory liability of the shareholder for debts of the corporation existing at the time of its dissolution, to an amount equal to the par value of his stock at the time, — the ordinary superadded individual liability, — a single creditor could bring an action at law against any single shareholder: he need not resort to a court of equity, or sue on behalf of himself and all other creditors, or join other stockholders or defendants.[4]

§ **3459. Georgia.** — A bank charter of Georgia made the stockholders liable for the ultimate redemption of the bills of the bank "in the same manner as in common actions of debt." This gave the billholder a remedy either at law or in equity. If he elected to proceed at law, he might elect any form of action appropriate to such a case and most advantageous to him, — as the action of *debt*.[5] So, a charter making the persons and property of the stockholders liable "in the same manner as in common commercial cases, or simple cases of debt," warranted an action of *assumpsit* by a billholder against a stockholder, — at least, no question was made as to this form of action.[6]

§ **3460. Illinois.** — A statute making the stockholders of certain corporations "liable to creditors of the company to an amount equal to the amount of stock held by them respectively, for all debts and contracts made by such company prior to the time when the whole

[1] Southmayd *v.* Russ, 3 Conn. 52. Compare Middletown Bank *v.* Magill, 5 Conn. 28.

[2] Laws Fla., ch. 3729.

[3] McClel. Dig. Fla. Stat., p. 232, § 20; *Id.*, p. 236, § 40.

[4] Gibbs *v.* Davis, 27 Fla. 531, 555; *s. c.* 8 South. Rep. 633.

[5] Adkins *v.* Thornton, 19 Ga. 325; Lane *v.* Morris, 8 Ga. 468; Mills *v.* Scott, 99 U. S. 25, 29. Compare Terry *v.* Tubman, 92 U. S. 156.

[6] Branch *v.* Baker, 53 Ga. 502.

amount of its capital stock shall have been paid in, and a certificate thereof made and filed," etc., has been held to create a legal liability out of which an implied promise arose, cognizable in a *court of law.* It was thought no objection that the stockholder might be subjected to several suits, as he could in no event be answerable for more than the amount of his stock.[1] Following the lead of this decision, the rule has become established in that State under various charter provisions creating an individual liability for a superadded amount equal to the par value of the shares owned by the stockholder, that an action at law may be maintained by a single creditor against any stockholder, the corporation being insolvent, to enforce the individual liability of the stockholder.[2] As already seen,[3] the Supreme Court of Illinois has planted itself on the broad, but seemingly untenable, ground, that where a statute creates a right but fails to prescribe a remedy to enforce it, the remedy is necessarily *at law.* Where the governing statute enacted that "all the stockholders of said corporation shall be severally and individually liable to the depositors to the amount of stock held by them respectively, and such liability shall continue for six months after the sale and transfer of said stock by any stockholder, and all suits brought against any stockholder must be commenced within six months from the time he shall cease to be a stockholder," — it was held that the remedy was necessarily *at law.*[4] The Supreme Court of Illinois also proceeds on the ground that the effect of their statutes is to create a *primary liability*, analogous to the construction placed upon the statutes of New York. Thus, where the statute enacted that "whenever default shall be made in the payment of any debt or liability contracted by said corporation, the stockholders shall be held individually responsible for an amount equal to the amount of the stock held by them, respectively," —it was said: "The effect of this is simply to withdraw from the stockholders, 'to an amount equal to the amount of

[1] Culver *v.* Third National Bank, 64 Ill. 528, 538.

[2] Corwith *v.* Culver, 69 Ill. 502 *(assumpsit);* Tibballs *v.* Libby, 87 Ill. 142 (trespass upon promises); Fuller *v.* Ledden, 87 Ill. 310 (debt); McCarthy *v.* Lavasche, 89 Ill. 270; *s. c.* 31 Am. Rep. 83 (holds that the remedy is at law); Arenz *v.* Weir, 89 Ill. 25 (action at law although receiver appointed); Buchanan *v.* Meisser, 105 Ill. 638 (debt); Meisser *v.* Thompson, 9 Ill. App. 368; Thompson *v.* Meisser, 108 Ill. 359 (action at law); Schalucky *v.* Field, 124 Ill. 617; *s. c.* 7 Am. St. Rep. 399; 21 Am. & Eng. Corp. Cas. 545; 16 N. E. Rep. 904.

[3] *Ante*, § 3414.

[4] Wincock *v.* Turpin, 96 Ill. 135, 142, 143.

stock held by them, respectively,' the protection of the corporation, and leave them *liable as partners;*"[1] citing some of the well-known New York cases. The foregoing views of the Supreme Court of Illinois prepare us for the conclusion that where the administration of an insolvent corporation has passed into the hands of a *receiver* appointed by one of the courts of the State sitting in equity, a bill in equity by the receiver, and such stockholders as may choose to join him, will not lie to enjoin the prosecution by creditors of separate actions at law against individual stockholders.[2] But where the liability is to *creditors as a class*,[3] then the Supreme Court of Illinois hold that the remedy is exclusively in equity, in order that there may be an equal distribution among creditors, and for the further reason (which would not of itself perhaps be controlling), that there may be an equal assessment upon the stockholders. It is so held under statutes which declare that, in a given event, the stockholders shall be liable "to the creditors" of the corporation.[4] Again, where a superadded statutory liability is created, and the statute does not in terms import that the liability is to the creditors *severally*, it is held that the effect of the statute is to create *a common fund* against which creditors can proceed in equity in an action brought by one in behalf of all who may choose to join, — and this, although there may be a concurrent remedy at law;[5] and where there will not be enough to satisfy all the creditors after subjecting all the stockholders to the individual liability imposed by the statute, equity will *enjoin* separate suits at law, and thus prevent individual creditors from getting a preference over the others.[6] In respect of the remedies against *domestic stockholders in foreign corporations*, the Supreme Court of Illinois, adopting the doctrine of the Supreme Judicial Court of Massachusetts,[7] hold that this is a matter requir-

[1] Buchanan *v.* Meisser, 105 Ill. 638, 642. So held in Thompson *v.* Meisser, 108 Ill. 359, 362; and in Schalucky *v.* Field, 124 Ill. 617, 622; *s. c.* 7 Am. St. Rep. 399.

[2] Wincock *v.* Turpin, 96 Ill. 135, 142. Scott and Sheldon, JJ., dissented.

[3] *Ante*, § 3434.

[4] Low *v.* Buchanan, 94 Ill. 76; Harper *v.* Union Man. Co., 100 Ill. 225; affirming *s. c.* 14 Ill. App. 220; Rounds *v.* McCormick, 114 Ill. 252; *s. c.* 29 N. E. Rep. 684; Hornor *v.* Henning, 93 U. S. 228. Compare Young *v.* Farwell, 139 Ill. 326.

[5] Queenan *v.* Palmer, 117 Ill. 619; following Eames *v.* Doris, 102 Ill. 350, which explained and qualified Wincock *v.* Turpin, 96 Ill. 135. See, also, Hickling *v.* Wilson, 104 Ill. 54.

[6] Eames *v.* Doris, *supra*.

[7] New Haven &c. R. Co. *v.* Linden Springs Co., 142 Mass. 349, 353.

ing *local administration*, and they therefore decline to entertain a bill in equity brought by creditors of a non-resident corporation against stockholders residing in Illinois.[1]

§ **3461. Indiana.** — The statute of this State,[2] which provides that stockholders and members of a *manufacturing and mining corporation* shall only be liable for the amount of the stock subscribed by them respectively, does not authorize a creditor to sue a stockholder or subscriber to the original articles of association for the amount of the unpaid stock or subscriptions; for the stockholder is not liable on account of the statute, but is liable to the corporation simply on his subscription, or to a receiver in case of its insolvency.[3] In other words, an *action at law* in this State does not lie in favor of a creditor for balances due on account of stock; and this is the general rule. This rule draws the administration into a court of equity, prevents separate creditors from suing separate stockholders at law, but gives to the receiver the remedies against the stockholder pointed out in a former section.[4]

§ **3462. Iowa.** — In this State, whose procedure is regulated by a *code*, before any stockholder can be charged with the payment of a judgment rendered against a corporation of which he is a stockholder, a proceeding by *ordinary action* must be instituted against him, and his liability determined therein.[5] Where there has been a *de facto* dissolution of the corporation, that is, where it has ceased to exist as a legal consequence of certain acts, and a party claims that he has been injured or benefited thereby, he may, by averring these facts, have his remedy, and need not in the first instance institute a proceeding, and have it declared that the existence of the corporation had terminated.[6]

§ **3463. Kansas.** — In this State, since the introduction of the Code of Civil Procedure, an action in the nature of an *action at law* lies, under a statute providing that the stockholders of certain corporations shall, "to the amount of the stock by them held, be jointly

[1] Young *v.* Farwell, 139 Ill. 326; *s. c.* 28 N. E. Rep. 845; affirming *s. c.* 35 Ill. App. 469.

[2] Ind. Rev. Stat. 1881, § 3869.

[3] Wheeler *v.* Thayer, 121 Ind. 64; *s. c.* 22 N. E. Rep. 972.

[4] *Ante*, § 3419. And see *post*, § 3549, *et seq.*

[5] Bayliss *v.* Swift, 40 Iowa, 648.

[6] Carey *v.* Cincinnati &c. R. Co., 5 Iowa, 357.

and severally liable for all the debts or responsibilities of such company." The court could not perceive why, when an action was given jointly and *severally* against a number of men, a man might not have his action against any one of them. If the stockholder thought he ought to have contribution, he might bring the other stockholders before the court.[1] So, an action at law is the proper remedy *in Missouri*, to enforce the "double liability" of a stockholder in a Kansas corporation to its creditors.[2]

§ **3464. Maine.**—In this State a remedy *at law* has been given to creditors of corporations against shareholders by express enactments.[3] But in the case of an *insolvent bank*, the receiver may, under a statute,[4] bring an action *in equity* against the stockholders to compel them to contribute to the payment of its debts.[5] In this State the private property of stockholders in corporations created after February 16, 1836, excepting banking corporations, was not made subject to *attachment* on a writ against the corporation. The creditor was obliged to obtain a judgment against the corporation before he could have his remedy against the corporators.[6] A statutory provision that the property of individual stockholders might be taken on execution where there was a deficiency of attachable corporate property, did not authorize an *attachment* against the property of members before judgment against the corporation.[7] If an individual stockholder in a corporation had its money in his hands, accruing from the sale of corporate property, another stockholder could recover his *proportion* of it in an action for money had and received,[8] but this could be done where the corporation had assented to a sale and distribution among the shareholders.

§ **3465. Maryland.**—In this State an action at law has been held to lie in behalf of the creditor of the corporation against the stockholder to enforce the liability created by the statute quoted below.[9] The Court of Appeals of this State, whilst conceding what

[1] Grund *v.* Tucker, 5 Kan. 70, 77.

[2] Bagley *v.* Tyler, 43 Mo. App. 195.

[3] Rev. Stat. Me. 1840, ch. 76, §§ 18–20; Came *v.* Brigham, 39 Me. 35; Cummings *v.* Maxwell, 45 Me. 190.

[4] Rev. Stat. Me. 1857, ch. 47, § 73.

[5] Dane *v.* Young, 61 Me. 160.

[6] Drinkwater *v.* Portland Railway, 18 Me. 35.

[7] *Ibid.*

[8] Hodsdon *v.* Copeland, 16 Me. 314.

[9] "All the stockholders of any such corporation shall be severally and individually liable to the credit-

it had previously held,[1] that the creditor might proceed in equity, yet saw no reason why a remedy should not also exist at law.[2]

§ 3466. Massachusetts.—It was at first held in Massachusetts that the only applicable remedy was the remedy in equity; and as no court in the Commonwealth had in that time equity powers, the rule operated to deny to creditors all remedy.[3] Later a remedy by an *action at law* was given by statute;[4] but this statute was in turn repealed,[5] leaving a suit in *equity the only remedy;*[6] and that is the only remedy in Massachusetts to this day.[7] This rule has been established in Massachusetts, under a statute providing that if any loss or deficiency of the capital stock in any bank shall arise from the official mismanagement of the directors, the stockholders shall, in their individual capacity, be liable to pay the same.[8] And where the statute gave a remedy by bill in equity, and also a right to *attach the body* or property of the shareholders, it was held that these remedies were exclusive: an ordinary action at law would not lie.[9] Nor can an action at law be maintained in Massachusetts to enforce the personal liability of a stockholder of a corporation established in another State, for a debt of the corporation, if the laws of that State provide that the remedy against a stockholder upon a debt of the corporation shall be by bill in chancery, and not otherwise.[10]

§ 3467. Minnesota.—Some confusion exists in the decisions in this State upon the question under consideration, which may per-

ors of the corporation in which they are stockholders, to an amount equal to the amount of stock held by them respectively, for all debts and contracts made by the corporation, until the whole amount of the capital stock fixed and limited by the corporation shall have been paid in,—one-half thereof in one year, and the other half thereof in two years, from and after the incorporation of said company,—or such corporation shall be dissolved." Md. Code, art. 26, § 52.

1 Matthews *v.* Albert, 24 Md. 527.

2 Norris *v.* Johnson, 34 Md. 485, 490. To the same effect are Norris *v.* Wrenchall, 34 Md. 492; Emmet *v.* Smith, 40 Md. 123.

3 Spear *v.* Grant, 16 Mass. 9, 15; Vose *v.* Grant, 15 Mass. 505, 522.

4 Gen. Stat. Mass. 1859, ch. 60, § 31.

5 Mass. Stat. 1862, ch. 218, § 10.

6 Bond *v.* Morse, 9 Allen (Mass.), 471.

7 Harris *v.* Dorchester, 23 Pick. (Mass.) 112; Crease *v.* Babcock, 23 Pick. 334; *s. c.* 10 Met. (Mass.) 525. All the subsequent cases in Massachusetts which the writer has examined were cases in equity.

8 Harris *v.* First Parish of Dorchester, 23 Pick. (Mass.) 112.

9 Knowlton *v.* Ackley, 8 Cush. (Mass.) 93.

10 Erickson *v.* Nesmith, 15 Gray (Mass.), 221. And see *ante*, § 3056.

haps be traceable to the confused and possibly contradictory state of the statute law on the subject. The first case which has come under the notice of the writer appears to have been an action brought under the Minnesota Code of Procedure, in the nature of an *action at law*, against a manufacturing corporation and three stockholders impleaded with it, to recover the amount of a judgment which the creditor had previously recovered against the corporation. What the court held really was, that the remedy against the stockholders was not *merged* by the recovery of a judgment against the corporation.[1] The governing law was a clause of the constitution of Minnesota reading that "each stockholder in any corporation shall be liable to the amount of stock held or owned by him." The next case in that State which has come under the notice of the writer, bearing upon this question, was an action by a single creditor against a single stockholder of a banking corporation, brought after the corporation has been wound up by an assignee under a general assignment made by it for its creditors, leaving a large amount of its debts unsatisfied. The governing statute recited "that the stockholders in each bank" formed pursuant to its provisions "shall be individually liable in an amount equal to double the amount of stock owned by them, for all the debts of such bank; and such liability shall continue for one year after any transfer or sale of stock by any stockholder or stockholders." It was held that this created a liability for *all* the debts,—in other words, to *all* the creditors regarded as a class, and that for this reason one creditor could not proceed against one stockholder. The court reasoned, much as other courts have done, upon the impropriety of allowing one creditor thus to get an advantage over the others out of a fund intended as a security for all; but placed its conclusion chiefly upon the ground of another statute applicable to all corporations,[2] authorizing, in permissive language by the use of the word "may," a proceeding in equity in behalf of all the creditors, against the corporation and all the shareholders. This proceeding the court held to be the *exclusive remedy*, on the ground that the statute which created the right had prescribed this as the remedy, and that it was conse-

[1] Dodge *v.* Minnesota &c. Roofing Co., 16 Minn. 368. In Johnson *v.* Fischer, 30 Minn. 173, 175, the preceding case is described as an action at law. See, also, *post*, § 3511.

[2] In Johnson *v.* Fischer, 30 Minn. 173, 176, the statute is described as applicable to all corporations.

quently the exclusive remedy under a well-understood rule of statutory construction.[1] In a subsequent case, where the question concerned the proper proceeding to take against stockholder in a manufacturing corporation, the court held, following the cases last cited, and for the reason last stated, that the remedy was exclusively a suit in equity prosecuted on behalf of all the creditors against the corporation and all the stockholders.[2] Soon after, with the same statutes in force, so far as the writer can see, the court whipped around and sustained an action brought by a single creditor of a manufacturing corporation against the corporation, joining some, not all, of the stockholders for the purpose of enforcing his demand against them in case the corporation should fail to satisfy it on its being reduced to judgment.[3] It is proper to state that the court found another provision of the general statute relating to the subject which entirely justified its conclusion; and two sections of the statute, quoted in the opinion, prescribe the very kind of action which was taken.[4] The confusion seems to have originated from the fact that in the earlier statutes of Minnesota two statutes existed providing for concurrent remedies, one for a remedy at law and another for a remedy in equity, and that these statutes were blended in a revision.[5] Later decisions in that State are to the effect that the statutory individual liability of stockholders may be enforced in a *statutory sequestration proceeding*.[6]

§ 3468. Missouri.—In Missouri, under the statute set out below,[7] a creditor may sue any stockholder *at law*, and the stock-

[1] Allen *v.* Walsh, 25 Minn. 543, 554; *ante*, §§ 1320, 1354.

[2] Johnson *v.* Fischer, 30 Minn. 173.

[3] Merchants' Nat. Bank *v.* Bailey Man. Co., 34 Minn. 323; *s. c.* 25 N. W. Rep. 639.

[4] Gen. Stats. Minn. 1878, ch. 34, §§ 10, 11.

[5] See the statement of Cornell, J., in Allen *v.* Walsh, 25 Minn. 543, 557.

[6] *Ante*, § 3431.

[7] "If any company formed under this act *dissolve*, leaving debts unpaid, suits may be brought against any person or persons who were stockholders at the time of such dissolution, without joining the company in such suit; and if judgment be rendered and execution satisfied, the defendant or defendants may sue all who were stockholders at the time of dissolution, for the recovery of the portion of such debt for which they were liable, and the execution upon the judgment shall direct the collection to be made from property of each stockholder respectively, and if any number of stockholders (defendants in the case) shall not have property enough to satisfy his or their portion of the execution, then the amount of deficiency shall be divided equally

holder thus compelled to pay may resort to his remedy for *contribution* against the others. But such a proceeding, whether at law or in equity, is not upon a joint liability, and can only reach the individual liability of each stockholder. If brought against more than one stockholder, it must necessarily be a proceeding in equity.[1] This action exists in Missouri, although under the present constitution[2] stockholders are liable only to the extent of what remains unpaid on their shares.[3] In two cases, where the liability of a stockholder arose under *statutes of other States*, it was held that the remedy was *at law;*[4] but in another such case, arising under the statutes of Illinois, it was held that the remedy was *in equity*,—at least that the defendant could not raise the question, having failed to *plead* a remedy at law.[5]

§ **3469. New York.**—The remedial system of this State furnishes no exception to the general rule that[6] where the object of

amongst all the remaining stockholders, and collections made accordingly, deducting from the amount a sum in proportion to the amount of stock owned by the plaintiff at the time the company dissolved." 1 Wag. Mo. Stat., p. 293, § 22; Rev. Stats. Mo. 1879, § 745; *Id.*, 1889, § 2519.

[1] Perry *v.* Turner, 55 Mo. 418, *per* Napton, J.

[2] *Ante*, § 3006.

[3] Farmers' Bank *v.* Gallaher, 43 Mo. App. 482; McGinness *v.* Barnes, 23 Mo. App. 413; Chouteau *v.* Dean, 7 Mo. App. 210. As to what is a *dissolution* of the corporation so as to let in this right of action, see *ante*, § 3345.

[4] Bagley *v.* Tyler, 43 Mo. App. 195, 201; Hodgson *v.* Cheever, 8 Mo. App. 318, 323.

[5] Shickle *v.* Watts, 94 Mo. 410, 418. The case of Hodgson *v.* Cheever, *supra*, arose under the laws of Illinois, as did Shickle *v.* Watts, in which State, as already seen (*ante*, § 3460) the remedy is a direct action by the creditor against the shareholder to enforce his individual superadded liability. But in Shickle *v.* Watts, *supra*, the creditor sought to charge the shareholder in respect to a balance unpaid on his shares, and, as elsewhere pointed out (*post*, § 3551), this was a right which had passed to a receiver of the foreign corporation in the State of Illinois, and in that regard the decision was an aberration. This decision was followed in the St. Louis Court of Appeals in a case where the corporation was what is known as a "tramp corporation," organized under the law of Illinois, but really domiciled in Missouri. A suit in equity by a judgment creditor against *two* of its stockholders, resident in Missouri, was sustained, apportioning the plaintiff's recovery between them according to their respective holdings. As in Shickle *v.* Watts, the defendants had failed to *plead* that there was a remedy at law; but, unlike that case, it did not appear that a receiver had been appointed to take charge of the assets of the corporation; it merely appeared that it had ceased business, abandoned its organization, and had no property subject to execution. Leucke *v.* Tredway, 45 Mo. App. 507.

[6] *Ante*, § 3428, *et seq.*

the creditor of the corporation is to subject to the satisfaction of his debt what remains unpaid by the shareholder in respect of his share subscription, the creditor must proceed *in equity*, bringing in the other stockholders, and that a single creditor cannot maintain an action at law against a single stockholder.[1] But, as already seen,[2] an action *at law* has been held to be an appropriate remedy in this State in behalf of a creditor against an individual stockholder of a corporation, formed under the act relative to the incorporation for manufacturing purposes, to recover a debt owing by the company at the time of its dissolution; and he was chargeable to the extent of his stock.[3] But the highest court of this State has recognized a principle stated by Mr. Chief Justice Waite in a passage already cited,[4] that whether an action at law will lie or not depends upon the nature of the liability created by the charter or governing statute. If a general personal liability is created, it may be enforced by personal action in the nature of an action at law, as other personal actions are enforced. If the charter merely permits the individual property of stockholders to be levied upon and taken in execution on a judgment against the corporation, and provides that the same process may be used and enforced by the stockholders whose property is first taken, against the property of the other stockholders so as to compel a ratable contribution by all, no

[1] Griffith *v.* Mangam, 73 N. Y. 611; Wellington *v.* Continental &c. Co., 5 N. Y. Supp. 587. The nature of the proceeding required by this rule is shown by the cases of Morgan *v.* New York &c. R. Co., 10 Paige (N. Y.), 290; *s. c.* 40 Am. Dec. 244; and Mann *v.* Pentz, 3 N. Y. 415.

[2] *Ante*, § 3078.

[3] Bank of Poughkeepsie *v.* Ibbotson, 24 Wend. (N. Y.) 473; Perkins *v.* Church, 31 Barb. (N. Y.) 84. In such an action, a general *averment* of dissolution was sufficient. Bank of Poughkeepsie *v.* Ibbotson, *supra.* Nor even that it was *insolvent*, except in those cases where the creditor was first required to exhaust his remedy against the corporation. Perkins *v.* Church, *supra.* Before *forms of action* were abolished in that State, *debt* was the proper remedy against a stockholder for a debt of the corporation for which he was made liable by its charter (Simonson *v.* Spencer, 15 Wend. (N. Y.) 548. See, also, Bullard *v.* Bell, 1 Mason (U. S.), 243); though under the charter of a steamboat company, which declared that "the members of the company shall be liable *individually*, in the same manner as carriers at common law, for the transportation of all goods," etc., an action on the *case* was sustained against some of the members, — there being no plea in abatement for non-joinder, — on the theory that their liability was that of partners. Allen *v.* Sewall, 2 Wend. (N. Y.) 327.

[4] *Ante*, § 3418; Terry *v.* Little, 101 U. S. 216.

general liability is created for which a personal action can be brought. In such case the creditor of the corporation is confined to the remedy against the stockholders, and their individual property given by the act.[1] Under the Code of Civil Procedure of this State,[2] which provides that when execution has been returned unsatisfied, the creditor may maintain an action against the debtor or any other person to compel the *discovery* of property or money due the debtor, and to procure a satisfaction of his demand, a judgment creditor of a foreign corporation, after the return of execution unsatisfied, may sue a stockholder indebted to the corporation for unpaid subscription for stock.[3]

§ **3470. Ohio.** — In Ohio an action to subject the individual *statute* liability of stockholders, which is in excess of their *contract* liability, must be instituted for the benefit of all the creditors; and the stockholders whose liability is sought to be enforced have the right to insist on their co-shareholders being made parties for the purposes of a general account, and to enforce from them contribution in proportion to their shares of stock;[4] and after such an action is brought, a single creditor cannot sue a separate shareholder.[5] But where a judgment creditor of an insolvent corporation commences an action against shareholders to enforce their individual liability, and, for aught that appears in the record, he is the only creditor and they the only shareholders, a demurrer to his petition will not lie. The equities between the holders of shares by assignment and their assignors who are parties to the suit, may be adjusted in the final decree.[6]

§ **3471. Oregon.** — In this State the liability of stockholders for the indebtedness of the corporation is limited to the amount of their share subscriptions, and the remedy to enforce this liability is *in equity*, where the rights of the corporation, the stockholder, and all creditors can be adjusted in one suit;[7] and the courts of the United

[1] Lowry *v.* Inman, 46 N. Y. 119.

[2] N. Y. Code Civ. Proc., § 1871.

[3] Persch *v.* Simmons, 3 N. Y. Supp. 783.

[4] Umsted *v.* Buskirk, 17 Ohio St. 113.

[5] Wright *v.* McCormack, 17 Ohio St. 86.

[6] Railroad Co. *v.* Smith, 48 Ohio St. 219. For *other examples* of such equitable actions in Ohio, see Morgan *v.* Lewis, 46 Ohio St. 1; Barrick *v.* Gifford, 47 Ohio St. 180; *s. c.* 21 Am. St. Rep. 798.

[7] Ladd *v.* Cartwright, 7 Or. 329.

States, applying the remedy existing in the particular State, according to the principle already stated,[1] apply the remedy in equity in actions to enforce the liability of a stockholder under the laws of Oregon.[2]

§ **3472. Pennsylvania.** — In Pennsylvania, under the statute relating to manufacturing companies,[3] the creditor proceeds by an action at law upon the original contract, joining the corporation and the stockholders;[4] and he may do this even though he is himself a creditor.[5] Nay, if he has been compelled to pay a debt of the corporation, and is suing for *contribution*, he proceeds at law against the company and his co-stockholders; the statute is held to exclude a resort to equity.[6] And though the corporation is the principal debtor, and the liability of the stockholders is only *secondary* and *collateral*, yet the form of the remedy and the character of the right, under the statutes of that State, allow the use of separate actions against the primary and secondary debtors.[7]

§ **3473. Rhode Island.** — The question seems to be governed in Rhode Island at the present time by a statute enacting as follows: "No person shall hereafter be imprisoned, or be continued in prison, nor shall the property of any such person be attached upon an execution issued upon a judgment obtained against a corporation of which such person is or was a stockholder."[8] "All proceedings to enforce the liability of a stockholder for the debts of a corporation shall be either by suit in equity, conducted according to the practice and course of equity, or by an action of debt upon the judgment obtained against such corporation; and in any such suit or action such stockholder may contest the validity of the claim upon which

[1] *Ante*, § 3453.

[2] Patterson *v.* Lynde, 106 U. S. 519.

[3] 2 Brightly's Purd. Dig. 998, § 30.

[4] Brinham *v.* Wellersburg Coal Co., 47 Pa. St. 43; Mansfield Iron Works *v.* Willcox, 52 Pa. St. 377; Hoard *v.* Wilcox, 47 Pa. St. 51; McHose *v.* Wheeler, 45 Pa. St. 32. But the corporation is not joined when a director is sued for improperly paying dividends. Hill *v.* Frazier, 22 Pa. St. 320.

[5] Brinham *v.* Wellersburg Coal Co., 47 Pa. St. 43.

[6] *Ibid.*

[7] Patterson *v.* Wyomissing &c. Co., 40 Pa. St. 117.

[8] R. I. Act of March 27, 1877, ch. 600, § 1. For an earlier decision under a *special charter*, under which the liability was held to be that of joint contractors, to be enforced by action *at law*, see New England Com. Bank

the judgment against such corporation was obtained, upon any ground upon which such corporation could have contested the same in the action in which such judgment was recovered."[1] This statute received a luminous exposition in a decision of the Supreme Court of the United States, where the opinion, written by Mr. Justice Gray, is characterized by the learning, research, and soundness of judgment which distinguish that eminent judge,—reaching the conclusion that an action cannot be maintained, under the statutes of Rhode Island, in that State, nor consequently in a court of the United States,[2] under the statutes of that State, by a creditor of a corporation against a stockholder, either at law or in equity, until the creditor has reduced his demand to a judgment against the corporation; and accordingly an action at law was repelled in a court of the United States for want of such a judgment against the corporation, even where it had been adjudged bankrupt.[3]

§ **3474. South Carolina.**—In this State, on grounds already set out,[4] the rule is, that where the charter of a corporation declares that "each stockholder shall be jointly and severally liable to the creditors" of the corporation, a single stockholder may be sued at law.[5]

§ **3475. Washington.**—Under the provisions of the code of this State making every stockholder "personally liable to the creditors of the company to the amount of what remains unpaid upon his subscription to the capital stock," the *unpaid subscriptions* constitute a trust fund, which *cannot be reached in an action at law* by a judgment creditor of the corporation against an individual stockholder;[6] and such is the general rule.[7]

v. Newport Steam Factory, 6 R. I. 154; *s. c.* 75 Am. Dec. 688.

[1] *Ibid.*, § 2.

[2] *Ante*, § 3453.

[3] Fourth Nat. Bank *v.* Francklyn, 120 U. S. 747, 755. On the point that the *bankruptcy* of the corporation does not relieve the creditor of the necessity of reducing his demand to a judgment against it, the decision, while holding to the letter of the statute, is perhaps opposed to other authority on the particular point. *Ante*, § 3367, *et seq.*

[4] *Ante*, §§ 3078, 3418.

[5] Hall *v.* Klinck, 25 S. C. 348; *s. c.* 60 Am. Rep. 505.

[6] Burch *v.* Taylor, 1 Wash. 245; *s. c.* 24 Pac. Rep. 438; Burch *v.* Glover, 1 Wash. 250; *s. c.* 24 Pac. Rep. 439; Burch *v.* Moore, 1 Wash. 249; *s. c.* 24 Pac. Rep. 439.

[7] *Ante*, § 3428, *et seq.*

§ 3476. Wisconsin. — Decisions in this State prescribe or indicate the remedy to be pursued by the creditor of the corporation in four classes of cases: 1. Where the liability of the stockholder is in respect of an unpaid subscription to his shares. In this case the proceeding is *in equity* by the creditor, on behalf of himself and all other creditors who may choose to join, and against the corporation and all the shareholders whom it is practicable to make parties.[1] But where the bill is by a judgment creditor to discover assets of the corporation alleged to have been transferred to the stockholder in fraud of his rights, it is not bad because not brought in behalf of all the creditors, nor because all the stockholders are not made defendants.[2] 2. Where the action is under the following provisions of the general banking law of Wisconsin: "The stockholders in every corporation or association organized under the provisions of this chapter shall be individually responsible, to the amount of their respective share or shares of stock, for all its indebtedness and liabilities of every kind."[3] Here the remedy is by a suit in equity, in which all the creditors should join, or one or more of them should sue for the benefit of all, against the corporation and all the stockholders whom it is practicable to serve with process.[4] A creditor may so proceed without having obtained a judgment at law against the corporation.[5] The court held that this liability was similar to that of *copartners* or members of an incorporated association,[6] but came to the conclusion, after thoroughly considering the subject, that an *action at law would not lie*, because the indebtedness of the company was one which a court of law had no power to regulate and adjust. The remedy was by *bill in equity*, brought by, or on behalf of, all creditors against the corporation, and all stockholders whom it was

[1] Adler *v.* Milwaukee Patent Brick Man. Co., 13 Wis. 57; Powers *v.* Hamilton Paper Co., 60 Wis. 23; *s. c.* 18 N. W. Rep. 20.

[2] Pierce *v.* Milwaukee Construction Co., 38 Wis. 253.

[3] Rev. Stat. Wis. 1858, ch. 71, § 18.

[4] Coleman *v.* White, 14 Wis. 700; *s. c.* 80 Am. Dec. 797; Carpenter *v.* Marine Bank, 14 Wis. 705, note; Merchants' Bank *v.* Chandler, 19 Wis. 434; Terry *v.* Chandler, 23 Wis. 456.

[5] Cleveland *v.* Marine Bank, 17 Wis. 545.

[6] Citing on this point Marcy *v.* Clark, 17 Mass. 330; Allen *v.* Sewall, 2 Wend. (N. Y.) 327; Sewall *v.* Allen, 6 Wend. (N. Y.) 335; Moss *v.* Oakley, 2 Hill (N. Y.), 265; Harger *v.* McCullough, 2 Denio (N. Y.), 119; Corning *v.* McCullough, 1 N. Y. 47; *s. c.* 49 Am. Dec. 287; Matter of Empire City Bank, 18 N. Y. 199, 218; Mokelumne Hill C. & M. Co. *v.* Woodbury, 14 Cal. 265; Wright *v.* Field, 7 Ind. 376; Planters' Bank *v.* Bivingsville Co., 10 Rich. L. (S. C.) 95.

practicable to join.[1] 3. Where the proceeding is to enforce a superadded liability of stockholders for debts due to the *clerks*, *servants*, and *laborers* of the corporation, under a statute.[2] Here the leading case in Wisconsin *was* a suit in equity, brought by a judgment creditor in his own behalf, as well as on behalf of all the creditors having similar claims against the corporation, and against all the stockholders. It was held that a judgment against the corporation was not a condition precedent to such an action, and the court left it undetermined whether it was necessary to make the corporation a party.[3] 4. Where the action is to enforce the personal liability of stockholders under another statute of the same State,[4] enacting that no stock corporation "shall transact business with any other than its members until at least one-half of its capital shall have been duly subscribed, and at least twenty per centum thereof actually paid in; and if any obligation shall be contracted in violation hereof, the corporation offending shall have no right of action thereon, but the stockholders then existing of such corporation shall be personally liable upon the same." This statute, under theories already explained,[5] makes, or rather *leaves*, the stockholders primarily and absolutely liable as principal debtors, and the liability is enforceable in an *action at law*, and not by a suit in equity, as there is nothing for the peculiar jurisdiction of equity to act upon.[6]

[1] Coleman *v.* White, 14 Wis. 700; *s. c.* 80 Am. Dec. 797; Carpenter *v.* Marine Bank, 14 Wis. 705, note.

[2] Rev. Stat. Wis. 1878, § 1769.

[3] Sleeper *v.* Goodwin, 67 Wis. 577; *s. c.* 31 N. W. Rep. 335.

[4] Rev. Stat. 1878, § 1873.

[5] *Ante*, §§ 3077, 3078.

[6] Flour City Nat. Bank *v.* Wechselberg, 45 Fed. Rep. 547. This conclusion is supported by a very satisfactory opinion written by Mr. District Judge Jenkins.

CHAPTER LXII.

PARTIES TO PROCEEDINGS BY CREDITORS AGAINST STOCKHOLDERS.

ART. I. CREDITORS AS PARTIES PLAINTIFF. §§ 3481–3489.
II. SHAREHOLDERS AS PARTIES DEFENDANT. §§ 3492–3505.
III. THE CORPORATION AS A PARTY DEFENDANT. §§ 3509–3515.

ARTICLE I. CREDITORS AS PARTIES PLAINTIFF.

SECTION
3481. Two theories as to the scope of equitable relief.
3482. Reconciling these theories.
3483. Theory that suit in equity must be on behalf of all creditors.
3484. Other creditors let in because entitled to share ratably.
3485. Amending bill or petition so as to make it the suit of all creditors.

SECTION
3486. When not necessary to join all creditors.
3487. Equity rule embodied in the codes of procedure.
3488. Dormant partners: *cestui que trust.*
3489. Creditors proceed separately at law.

§ 3481. Two Theories as to the Scope of Equitable Relief. As to the nature of the proceeding and the scope of the relief, there are two theories. One is, that the creditor must bring his action, not only in his own behalf, but also in behalf of all other creditors who may choose to join, and not only against the corporation, but also against all the stockholders whom it is practicable to serve with process; to the end that, so far as practicable, all the debts may be satisfied and equality preserved among the creditors, and all the stockholders assessed and the burdens equalized among them.[1] The other theory is, that the cred-

[1] The cases of Adler *v.* Milwaukee &c. Co., 13 Wis. 57; Coleman *v.* White, 14 Wis. 700; *s. c.* 80 Am. Dec. 797; Griffith *v.* Mangam, 73 N. Y. 611; Morgan *v.* New York &c. R. Co., 10 Paige (N. Y.), 290; *s. c.* 40 Am. Dec. 244; and Mann *v.* Pentz, 3 N. Y. 415,— are types of this theory.

itor who has exhausted his remedy at law and who seeks the aid of equity, is not bound to proceed in behalf of other creditors and to shake the tree in order that they may come in and help him pick up the fruit, and that he has nothing to do with adjusting the equities among the stockholders; but that, having exhausted his remedies at law, he is entitled to the aid of equity to discover and subject to the payment of his debt any assets of the corporation wherever he can find them, whether in the possession of a stockholder or elsewhere.[1] This theory applies where the assets intended to be subjected by the creditor consist of what is due by the stockholder to the corporation in respect of his shares.[2] In such cases it is held that the complainant is under no obligation to make all the stockholders defendants in his bill; but the stockholders against whom he does proceed may secure protection against an unequal assessment, if so minded. They may, it has been said, move for a *receiver*, or file a *cross-bill*, and thereby obtain a discovery of the other stockholders, and have them brought in, and enforce contribution against all who have not paid their subscriptions.[3] This doctrine has been recently assented to by the Supreme Court of Illinois; yet, as that court points out, it is impossible for defending stockholders to file such a cross-bill and secure a contribution in the case of a foreign corporation, because no account can be taken of its indebtedness, and no decree can be rendered winding up its affairs and apportioning its delinquent stockholders who are solvent, for the mere reason that it is beyond the jurisdiction of the court. The conclusion is, that in such a case the equitable administration must be had within the State creating the corporation,

[1] A type of this doctrine is found in the cases of Hatch *v.* Dana, 101 U. S. 205; Ogilvie *v.* Knox Ins. Co., 22 How. (U. S.) 380; Bartlett *v.* Drew, 57 N. Y. 587; Pierce *v.* Milwaukee Construction Co., 38 Wis. 253; Marsh *v.* Burroughs, 1 Woods (U. S.), 468; Hickling *v.* Wilson, 104 Ill. 54.

[2] Cases last cited.

[3] Hatch *v.* Dana, 101 U. S. 205, 214, opinion of the court by Mr. Justice Strong, recognized in Young *v.* Farwell, 139 Ill. 326, 332. In Briggs *v.* Penniman, 8 Cow. (N. Y.) 387; *s. c.* 18 Am. Dec. 454, it is suggested by Woodworth, J., that those creditors who are also stockholders should seek a *ratable distribution* by filing a cross-bill.

and that a bill in equity will not lie against separate stockholders domiciled in another State.[1]

§ **3482. Reconciling These Theories.** — It seems difficult, at first blush, to reconcile these two opposing theories, which we find often expressed in the decisions of the same court;[2] but although many of these decisions are unquestionably irreconcilable, yet many — perhaps most — others can be reconciled if a little attention is given to the governing principle. That principle is, that it is only where the circumstances are such that an equitable distribution for the benefit of all *must* be made, as where an executor pleads *want of sufficient assets*, that the rule applies requiring all parties having a claim on the common fund to join, as plaintiffs, either in person or by representation. In other words, a court of equity will not allow a single creditor to proceed where it appears: 1. That there are other creditors; and 2. That there is not enough for all — in other words, that the particular creditor is endeavoring to use a court of equity as the instrument of getting an advantage over other creditors who stand equal with him in right. With this principle in view, it must be concluded that a bill is not demurrable, or that a complainant will not be put out of court at any stage of the proceeding, unless it appears not only that there are other creditors standing equal with him in right, but that there is not enough for all, and that the granting of the relief which he seeks will take from them some portion of their ratable share of the assets of the common debtor. A further consideration is, that although a single creditor may proceed alone without mentioning other creditors or proceeding in their behalf, yet this will not prevent them from coming in and being made co-plaintiffs on

[1] Young *v.* Farwell, 139 Ill. 326; *s. c.* 28 N. E. Rep. 845; affirming *s. c.* 35 Ill. App. 469.

[2] For instance, compare Hatch *v.* Dana, 101 U. S. 205, with Handley *v.* Stulz, 137 U. S. 366; and Mann *v.* Pentz, 3 N. Y. 415, with Bartlett *v.* Drew, 57 N. Y. 587; and Adler *v.* Milwaukee Patent Brick Co., 13 Wis. 57, with Pierce *v.* Milwaukee Construction Co., 38 Wis. 253. Similar discrepancies on this question can be traced in the decisions of many other courts.

their own petition; and unless they have been guilty of laches, it is believed that there is no principle which will keep them out. These views are supported by the observations of Mr. Justice Lord, of the Supreme Court of Oregon, in a case where the subject underwent careful consideration: "When the object of the bill is to settle or wind up the affairs of the corporation which is insolvent, and it becomes necessary to ascertain the whole amount of the indebtedness, and to whom due, and also who are liable to contribute upon their unpaid stock subscriptions, the necessity of bringing the suit in the name and for the benefit of all the creditors of the corporation, and against all the stockholders found within the jurisdiction, is conceded. But when the bill is not brought for that purpose, although in the form of an ordinary creditor's bill, as the case here, but seeks solely to obtain the payment of the plaintiff's judgment, and it does not appear by the bill, or otherwise, that there are any other creditors who wish to be made parties, a judgment creditor who has exhausted his legal remedy ought not to be stayed in his suit to pursue any equitable interest or demand of his debtor, in the absence of any showing by them objecting that there are any other creditors."[1]

§ 3483. Theory That Suit in Equity Must be on Behalf of all Creditors. — The *general rule* is, that a creditor who proceeds in chancery to subject the liability of the shareholders of an insolvent corporation must bring his bill on behalf of all other creditors, who may come in and establish their debts according to the course of a court of chancery. Whilst liens and legal priorities are preserved, he does not obtain a preference over other creditors by the filing of such a bill, but the property of the corporation, or the sums due from other shareholders in respect to their individual liability, are sequestered for the ratable benefit of all the creditors.[2] Under any theory, whenever the creditor proceeds in

[1] Brundage *v.* Monumental &c. Mining Co., 12 Or. 322, 325.

[2] Morgan *v.* New York &c. R. Co., 10 Paige (N. Y.), 290; *s. c.* 40 Am. Dec. 244; Mann *v.* Pentz, 3 N. Y. 415; Masters *v.* Rossie Lead Mining Co., 2

right of the corporation, — that is to say, whenever the equitable assets which he seeks to reach and subject are assets of the corporation, this form of procedure is always permissible, even where there may be a separate statutory remedy at law by a direct action.[1]

§ **3484. Other Creditors Let in because Entitled to Share Ratably.**—This does not mean that the creditor who files the bill is under any obligation to look up all the widely scattered creditors of the corporation, and get their consent to the filing of the bill, or notify them to join him in it.[2] It has long been settled that a judgment creditor who has exhausted his legal remedy by an execution returned *nulla bona* may alone, or with other judgment creditors, file a bill against persons holding property of the debtor, which, on account of fraud or the existence of a trust, cannot be reached by execution.[3] "Where a case exists in which a fund can only be divided satisfactorily among a certain class of persons, it is necessary to frame the decree in such a manner that all these persons may be brought in for their distributive shares; but even then the bill may often be filed by any one of them on his

Sandf. Ch. (N. Y.) 301; Coleman *v.* White, 14 Wis. 700; *s. c.* 80 Am. Dec. 797; Crease *v.* Babcock, 10 Met. (Mass.) 525; Grew *v.* Breed, 10 Met. (Mass.) 569; Carpenter *v.* Marine Bank, 14 Wis. 705, note; Umsted *v.* Buskirk, 17 Ohio St. 113, 118; First Nat. Bank *v.* Hingham Man. Co., 127 Mass. 563; Pope *v.* Leonard, 115 Mass. 286 (conforming to a statute); Handley *v.* Stutz, 137 U. S. 366; Sheriff *v.* Oil Co., 7 Phila. (Pa.) 4; Harper *v.* Union Man. Co., 100 Ill. 225; Moore *v.* Reynolds, 109 Mass. 473; Bickley *v.* Schlag, 46 N. J. Eq. 533; *s. c.* 20 Atl. Rep. 250; Von Glahn *v.* Harris, 73 N. C. 323; Von Glahn *v.* Lattimer, 73 N. C. 333; Von Glahn *v.* De Rossett, 76 N. C. 292.

[1] Baines *v.* Babcock, 95 Cal. 581; *s. c.* 29 Am. St. Rep. 158.

[2] This language, which is adopted from the author's former work on stockholders (Thomp. Stockh., § 351), is quoted with approval in Thompson *v.* Reno Savings Bank, 19 Nev. 103; *s. c.* 3 Am. St. Rep. 797, 805.

[3] Marsh *v.* Burroughs, 1 Woods (U. S.), 467, *per* Mr. Justice Bradley; citing to this point, McDermutt *v.* Strong, 4 Johns. Ch. (N. Y.) 687; Spader *v.* Davis, 5 Johns. Ch. (N. Y.) 280; Lentilhon *v.* Moffat, 1 Edw. Ch. (N. Y.) 451; Dix *v.* Briggs, 9 Paige (N. Y.), 595; Storm *v.* Waddell, 2 Sandf. Ch. (N. Y.) 494; Ogilvie *v.* Knox Ins. Co., 22 How. (U. S.) 380; Dunphy *v.* Kleinsmith, 11 Wall. (U. S.) 610.

own behalf. It is only when it appears to the court, by the subsequent pleadings or otherwise, that a distribution must be made (as where an executor pleads want of sufficient assets), that a decree will be made for the benefit of all. In this case,[1] what law compels an equal distribution of the fund sought to be reached amongst all the creditors? The assets in the hands of the assignee are subjected to such law, because they have been granted to him in trust for all creditors equally. But it is conceded that the unpaid capital stock is not subject to the assignment. If subjected to the demands of the complainants or judgment creditors, it will be exonerated *pro tanto* from all further demands."[2] The meaning is that two or more creditors may join as plaintiffs, but that their joining is not compulsory, though they must proceed for themselves and all others who may choose to come in and share with them the costs of the litigation.[3] A *prayer for relief* that the defendants be ordered "to pay to the plaintiffs, and to such other creditors as may become parties to the bill," the amounts due them, is not repugnant to a bill so framed, though those creditors only who become parties reap all the benefits of the proceeding.[4] This is no more than an application of a well-known rule of chancery procedure, by which, where there are numerous parties belonging to a class, and possessing a common right of action, they may prosecute their action *by representation*, that is, by one or more of them actually proceeding as plaintiffs.[5] If a bill is brought in

[1] The creditors in this bill were proceeding under a bank charter similar to that before the Supreme Court of the United States in Pollard *v.* Bailey, 20 Wall. (U. S.) 520, which provided that the persons and property of the stockholders should at all times be liable, pledged, and bound for the redemption of the bills and notes at any time issued, in proportion to the number of shares that each individual and corporation might hold and possess.

[2] Marsh *v.* Burroughs, 1 Woods (U. S.), 463, 467, *per* Mr. Justice Bradley.

[3] Semmes *v.* Mott, 27 Ga. 92; Hickling *v.* Wilson, 104 Ill. 54.

[4] First Nat. Bank *v.* Hingham Man. Co., 127 Mass. 563.

[5] The rule is clearly explained by Chancellor Walworth in Hallett *v.* Hallett, 2 Paige (N. Y.), 15, 19. See, also, McKenzie *v.* L'Amoureux, 11 Barb. (N. Y.) 516.

behalf of the plaintiff and such others having a like interest as may come in to aid him in prosecuting the suit, and no others come in, the plaintiff has control of the suit for himself alone; though, in order to obtain equitable relief, he must show that he himself is entitled to it.[1]

§ 3485. Amending Bill or Petition, so as to Make It the Suit of All Creditors. — It is said in an authoritative work on chancery practice that "the court will generally, at the hearing, allow a bill, which has originally been filed by one individual of a numerous class in his own right, to be amended, so as to make such individual sue on behalf of himself and the rest of the class." [2] Such an amendment has been upheld when made immediately before the trial or hearing, where the court, by its decree, allowed the remaining creditors a reasonable time — thirty days from the entry of the decree — within which to prove their claims, and share with the plaintiff in the distribution of the trust fund.[3] Nor, in such a case, is *notice* to the other creditors necessary.[4] Where new parties plaintiff join, and other stockholders are brought in, pending the hearing before the master, it is not necessary that the pleadings should be formally amended, so as to join issue as to the additional parties.[5]

§ 3486. When not Necessary to Join All Creditors. — In several jurisdictions, under particular statutes, the rule obtains that the creditor, having exhausted his remedy at law, may proceed in equity to enforce the unpaid subscriptions of the stockholders, *without joining all of the creditors or all*

[1] Hubbell *v.* Warren, 8 Allen (Mass.), 173.

[2] 1 Dan. Ch. Prac. 245; citing Lloyd *v.* Loaring, 6 Ves. 773. See, also, Milligan *v.* Mitchell, 1 Myl. & C. 433; Gwatrein *v.* Campbell, 1 Jur. (N. S.) 131; Reese River &c. Co. *v.* Atwell, L. R. 7 Eq. 347.

[3] Thompson *v.* Reno Sav. Bank, 19 Nev. 103; *s. c.* 3 Am. St. Rep. 797, 805.

[4] *Ibid.*

[5] Bailey *v.* Pittsburgh Coal R. Co., 139 Pa. St. 213; *s. c.* 21 Atl. Rep. 72. That an *amendment* joining other creditors is allowable, see Aultman's Appeal, 98 Pa. St. 505.

of the stockholders.[1] Under a statute of Minnesota,[2] a creditor of a corporation of the class therein provided for may sue the corporation for the debt, and join, as defendants, one or more of the stockholders to enforce their individual liability; and all the creditors of the corporation need not be joined, nor all the stockholders subject, to individual liability.[3] In Wisconsin, where the suit in equity is in the form of a creditor's suit, under a statute regulating that remedy, it need not be brought on behalf of all creditors, nor against all stockholders;[4] but where the suit is brought under the statute relating to proceedings against corporations, for all creditors and against all shareholders,[5] a separate creditor's suit will be enjoined.[6]

§ 3487. Equity Rule Embodied in the Codes of Procedure. Some of the codes of procedure[7] embody the foregoing rule of equity procedure, requiring all who have a common interest to join when that is practicable, but where it is not practicable, allowing one or more to proceed for the others by representation.[8] Under such a statutory provision, a complaint is not demurrable for defect of parties where the plaintiff sues for all other creditors, or where he fails to bring in stockholders whose names are not known.[9]

[1] Appeal of Cornell, 114 Pa. St. 153; *s. c.* 6 Atl. Rep. 258, under Penn. Act of 1836; Bartlett *v.* Drew, 57 N. Y. 587; Thompson *v.* Reno Sav. Bank, 19 Nev. 103; *s. c.* 3 Am. St. Rep. 797, 808; Marsh *v.* Burroughs, 1 Woods (U. S.), 467; Brundage *v.* Monumental Gold &c. Min. Co., 12 Or. 322 (under a statute of individual liability).

[2] Minn. Gen. Stat., ch. 34, §§ 9–11.

[3] Merchants' Bank *v.* Bailey Man. Co., 34 Minn. 323.

[4] Pierce *v.* Milwaukee Construction Co., 38 Wis. 253.

[5] Cleveland *v.* Marine Bank, 17 Wis. 545; Coleman *v.* White, 14 Wis. 700; *s. c.* 80 Am. Dec. 797; Carpenter *v.* Marine Bank, 14 Wis. 705, note.

[6] Pierce *v.* Milwaukee Construction Co., 38 Wis. 253.

[7] For instance, N. C. Code, 1883, § 185; Gen. Stat. Nev. 1885, § 36.

[8] For comments on this code provision, see Pom. Rem., § 391; also, Bronson *v.* Wilmington &c. Life Ins. Co., 85 N. C. 411, 414, where the language of Professor Pomeroy is quoted with approval.

[9] Bronson *v.* Wilmington &c. Life Ins. Co., 85 N. C. 411; Glenn *v.* Farmers' Bank, 72 N. C. 626. Such an objection was made in Von Glahn *v.* De Rosset, 81 N. C. 467, though it was not passed upon, the case going off on another question.

§ 3488. Dormant Partners — Cestui que Trust. — If the complainant is a partnership, it is not necessary to join *dormant* partners in the bill, but it will be sufficient if the bill is filed by the partner in whose name the business was carried on. A decree under such a bill will conclude the dormant partners as fully as though they had been joined as complainants.[1] Nor need a trustee in whom the legal title to a debt or chose in action vests join his *cestui que trust* as a co-plaintiff.[2]

§ 3489. Creditors Proceed Separately at Law. — The leading contrast between the legal and equitable mode of procedure against stockholders by creditors of the corporation is suggested by what has preceded. The creditors have *no joint right of action at law*, and, in the absence of a statute changing the general rule, cannot sue jointly in that forum, but each must sue for himself. To throw the legal and equitable modes of procedure into immediate contrast, let us turn to the State of New York, where the legal method generally obtains in enforcing the superadded individual liability of stockholders,[3] but where the equitable method exclusively obtains in sequestering for creditors what remains unpaid by the shareholders in respect of their share subscriptions.[4] In the former case each stockholder sues alone, and it is not necessary for him to proceed in behalf of himself and other creditors.[5] In

[1] Bank of St. Mary's *v.* St. John, 25 Ala. 566, 621. Compare Lloyd *v.* Archbowle, 2 Taunt. 324; Lucas *v.* De la Cour, 1 Mau. & Sel. 249; Bryden *v.* Taylor, 2 Har. & J. (Md.) 396; *s. c.* 3 Am. Dec. 554; Mitchell *v.* Dall, 2 Har. & G. (Md.) 159.

[2] Grew *v.* Breed, 10 Met. (Mass.) 569. Upon the question in whom the right of action vested under early *banking charters*, making the stockholders personally liable to the *bill-holders*,—Johnston *v.* Southwestern R. Bank, 3 Strobh. Eq. (S. C.) 263; Vose *v.* Grant, 15 Mass. 505 (holding it vested in those who were billholders at the time when the *dividend* was improperly declared); Crease *v.* Babcock, 10 Met. (Mass.) 525; Grew *v.* Breed, 10 Met. (Mass.) 569 (holding it vested in those who acquired the *legal title* to the bills in the ordinary course of business).

[3] *Ante*, § 3469.

[4] *Ibid.*

[5] Woodard *v.* Holland Medicine Co., 39 N. Y. St. Rep. 411; *s. c.* 10 Rail. & Corp. L. J. 213; 15 N. Y. Supp. 128.

the latter case the creditor must proceed in equity, not only for himself, but in behalf of all other creditors who may choose to come in and be made parties.[1]

ARTICLE II. SHAREHOLDERS AS PARTIES DEFENDANT.

SECTION
3492. Two courses open to the creditor.
3493. Theory that all shareholders within jurisdiction are necessary parties to creditor's bill.
3494. Contrary theory that it is not necessary to join all the stockholders.
3495. Stockholders out of the jurisdiction need not be joined.
3496. All stockholders proper parties.
3497. Not necessary to make shareholders defendants in order to secure appointment of receiver.
3498. Joint action by a single creditor against all the stockholders.

SECTION
3499. Recent theory that stockholders are not necessary parties to a winding-up bill.
3500. Stockholders must be sued separately at law.
3501. Except where they are liable as simple partners.
3502. Separate and joint actions to enforce limited and unlimited liability.
3502a. Rules in particular jurisdictions.
3503. Summoning the stockholder with the corporation.
3504. Whether stockholder so summoned can contest the merits.
3505. Where stock is held by partnership firm.

§ **3492. Two Courses Open to the Creditor.** — In such cases as those contemplated in the preceding article, two courses are open to the creditor. The first is, to make the stockholders parties defendant in *his* creditor's suit, to procure an order of the court in that suit, assessing them to raise funds for the payment of *his* debt, and to enforce the order against them by the usual process of the court.[2] The other is the course suggested by a preceding section,[3] to bring the suit *on behalf of all the creditors*, to procure the appointment of a receiver, to have an account taken and stated, and an assessment upon all the shareholders ordered, and to enforce that assessment by supplementary actions brought by the receiver

[1] Mann *v.* Pentz, 3 N. Y. 415.

[2] This was the course pursued and sanctioned in the following, among other, cases: Adler *v.* Milwaukee Patent Brick Man. Co., 13 Wis. 63; Ogilvie *v.* Knox Ins. Co., 22 How. (U. S.) 380; Hatch *v.* Dana, 101 U. S. 205; Ballin *v.* Loeb, 78 Wis. 404; *s. c.* 47 N. W. Rep. 516; 10 L. R. A. 742 (under a statute).

[3] *Ante*, § 3481.

wherever the shareholders may be found.[1] Where the latter course is taken, no objection is perceived to mingling the two kinds of procedure so far as to make such stockholders as may be found within the jurisdiction parties defendant, and to rendering decrees against them *in personam*, without requiring the receiver to bring separate actions at law against them,—which practice is sanctioned by the decisions first above cited. This would leave him free to bring actions at law against such stockholders as might reside in other jurisdictions, as was done in the Glenn cases.

§ 3493. Theory that All Shareholders within Jurisdiction are Necessary Parties to Creditors' Bill.—According to a widely prevailing theory, a creditors' bill, such as we are considering, brought in behalf of all creditors, wherein the court undertakes to adjust the equities, and do justice to all, must be brought against all the shareholders, unless some valid excuse is shown for not bringing them in.[2] This must necessarily be so, unless it is conceded that the shareholders may be bound by representation through the corporation;[3] otherwise, the main object of asserting the jurisdiction of

[1] This remedy is suggested by the Glenn cases, often referred to in this title, where the liquidator of the company was a trustee, substituted by a State court in Virginia in the place of other trustees appointed by the insolvent corporation in a voluntary deed of trust made by it for the benefit of its creditors. See Glenn *v.* Liggett, 135 U. S. 533; Hawkins *v.* Glenn, 131 U. S. 319, and numerous cases there referred to in the brief.

[2] Hadley *v.* Russell, 40 N. H. 109; Erickson *v.* Nesmith, 46 N. H. 371; Mann *v.* Pentz, 3 N. Y. 415; Pierce *v.* Milwaukee Construction Co., 38 Wis. 253; Adler *v.* Milwaukee Brick Co., 13 Wis. 57; Coleman *v.* White, 14 Wis. 700; *s. c.* 80 Am. Dec. 797; Carpenter *v.* Marine Bank, 14 Wis. 705, note; Cleveland *v.* Marine Bank, 17 Wis. 545; Umsted *v.* Buskirk, 17 Ohio St. 113, 118; Griffith *v.* Mangam, 73 N. Y. 611; Morgan *v.* New York &c. R. Co., 10 Paige (N. Y), 290; *s. c.* 40 Am. Dec. 244; Wellington *v.* Continental Const. &c. Co., 52 Hun (N. Y.), 408; *s. c.* 24 N. Y. St. Rep. 678; 5 N. Y. Supp. 587; Curran *v.* Bradner, 27 Ill. App. 582; Terry *v.* Martin, 10 S. C. 263; Von Glahn *v.* Harris, 73 N. C. 323; followed in Von Glahn *v.* Lattimer, 73 N. C. 333; and in Von Glahn *v.* De Rossett, 76 N. C. 292; Dunston *v.* Hoptonic Co., 83 Mich. 372; *s. c.* 47 N. W. Rep. 322; 9 Rail. & Corp. L. J. 67; 31 Am. & Eng. Corp. Cas. 475; Friend *v.* Powers, 93 Ala. 114; *s. c.* 9 South. Rep. 392.

[3] *Post*, § 3499.

equity, the equalizing of the burden of the shareholders and the preventing of the multiplicity of suits, would be defeated.[1] Under such a bill an account will be taken of the debts and assets of the corporation, of the amount of capital not paid in, and of the amount due from each shareholder.[2] Another theory is, that, as a party cannot be concluded in respect of his rights in a proceeding to which he is not a party, such not being due process of law, a stockholder is of right entitled to be joined in an action brought for the establishment of rights which are to be enforced against him.[3] But, as we have already seen, the prevailing view is, that he is present in the person of the corporation *by representation*, and is, therefore, not entitled to be specially made a party.[4] But on no theory can his rights be finally disposed of in his absence. Although, the court, without making him a party, order that the corporation be wound up, and that the stockholders be assessed in a certain amount, and appoint a receiver to collect the assessments, yet when it comes to enforcing this order against the individual stockholder, he is, of course, entitled to show that he is no stockholder, and that he has paid in full, or that he has a valid and sufficient off-set, or that he is otherwise not amenable to the order; and for this purpose he is entitled to his "day in court."[5] It has been held that an omis-

[1] *Ante*, § 3432.

[2] Mann *v.* Pentz, 3 N. Y. 415, and other cases above cited. On the question whether it is necessary to sue all the stockholders, see a learned note in 15 Am. & Eng. Corp. Cas. 535. In Pennsylvania it is said that in cases arising under the Manufacturing Act of 1849, a creditor intending to hold the stockholders of a company for its debts must join them, or *a portion of them*, in his action against the company. Mansfield &c. Works *v.* Willcox, 52 Pa. St. 377. But why a portion of them, if they are all within the jurisdiction and accessible? In Louisiana the stockholders, through *residing in different parishes*, may be sued for contributions before the court liquidating the bank. Stark *v.* Burke, 5 La. Ann. 740.

[3] See, for instance, Lamar Ins. Co. *v.* Gulick, 102 Ill. 41; as explained in Great Western Tel. Co. *v.* Gray, 122 Ill. 630. Compare Bergen *v.* Porpoise Fishing Co., 42 N. J. Eq. 397; *s. c.* 8 Atl. Rep. 523.

[4] *Ante*, §§ 3392, 3395; *post*, § 3499.

[5] An assessment made by a receiver pursuant to an *ex parte* order of the court is not conclusive upon a stockholder, but may be questioned by him in an action to recover it. Cuykendall *v.* Corning, 88 N. Y. 129.

sion, in a judgment creditor's bill against a part of the stockholders in a corporation, to make all the stockholders parties, is not excused by a *general allegation* that some of the stockholders were *insolvent*, *minors*, and *non-residents*, as such allegation does not show that all were made parties who should contribute to the payment of the corporate debts.[1]

§ 3494. Contrary Theory that It is not Necessary to Join All the Stockholders.—As already indicated,[2] there is a contrary theory that, in a creditor's bill by the judgment creditor of a corporation to subject what may be due to the corporation from the stockholder in respect of his shares, it is not necessary to join all the stockholders to the end that there may be a ratable contribution among them all, but that if the stockholder or stockholders against whom the creditor does proceed, seeks contribution from those who are not joined, he must do it at his own expense, and cannot compel a creditor to undergo that expense.[3] This rule is often stated in the double proposition that in such a case it is neither necessary to proceed in behalf of all the creditors nor against all the stockholders.[4] The great reputation of the late Justice Bradley has made a decision of his at circuit a leading case on this point.[5] Cases are sometimes cited in affirmance of this principle, which really rest on the provisions of statutes.[6] It has

[1] Dunston *v.* Hoptonic Co., 83 Mich. 372; *s. c.* 47 N. W. Rep. 322; 9 Rail. & Corp. L. J. 67; 31 Am. & Eng. Corp. Cas. 475.

[2] *Ante*, § 3486.

[3] Thompson *v.* Reno Sav. Bank, 19 Nev. 103; *s. c.* 3 Am. St. Rep. 797, 808; Hatch *v.* Dana, 101 U. S. 205, 210; Ogilvie *v*, Knox Ins. Co., 22 How. (U. S.) 380; Cornell's Appeal, 114 Pa. St. 153; Baines *v.* Babcock, 95 Cal. 581; *s. c.* 29 Am. St. Rep. 158; 30 Pac. Rep. 776; Baines *v.* Story (Cal.), 30 Pac. Rep. 777.

[4] *Ante*, § 3481.

[5] Marsh *v.* Burroughs, 1 Woods (U. S.), 463, 468 (1871). Compare Pollard *v.* Bailey, 20 Wall. (U. S.) 520.

[6] See, for instance, Chandler *v.* Brown, 77 Ill. 333, which was followed in Lamar Ins. Co. *v.* Gulick, 102 Ill. 41, and explained and limited in Great Western Tel. Co. *v.* Gray, 122 Ill. 630. A case in New York, which is sometimes cited in affirmance of the same principle, merely held that where the charter of a private corporation provided that all its stockholders should be jointly and severally liable, to the nominal amount of their stock, for all its debts, and that a creditor, whose demand has been presented to the

been held that the *personal liability of directors*, under a statute, for assenting to the contracting of debts beyond the amount of the capital stock, is individual and several, and one may be sued *in equity* without seeking out the others.[1]

§ 3495. Stockholders out of the Jurisdiction Need not be Joined.—Under any of the foregoing theories, stockholders residing out of the jurisdiction need not, because they *cannot*, be joined. In the celebrated case of Wood *v.* Dummer,[2] the head-note states that it was decided that a bill in equity to charge shareholders on account of a dividend of the capital stock of the company improperly received by them, might be maintained by *some* of the creditors against *some* of the shareholders, the impossibility of bringing all before the court being sufficient to dispense with the ordinary rule of making all parties in interest parties to the proceeding. But it does not appear from the report that any question was made as to a defect of parties; and, besides, the decree of the court was so framed as to save the rights both of the stockholders before the court and of the absent creditors. In New Hampshire the question was presented in a manner which received mature consideration. Some of the stockholders of a New Hampshire corporation resided in Massachusetts. The plaintiff had proceeded against them there and failed, on the ground, it would seem, that they were denied the privilege of enforcing against the inhabitants of another State the special provisions of the laws of New Hampshire.[3] He then filed a bill in New Hampshire against all the shareholders; but many of them, residents of

proper officers of the corporation for payment, and payment thereof refused, might sue any one or more of the stockholders,—the creditor might, under the provisions of 2 Rev. Stat. N. Y. 461, file his bill in equity against the company and such stockholders as he knew, in order to charge them with the payment of the debt, and might pray a discovery of the names and residences of the unknown stockholders, and of the amount of stock held by them, *with a view to amend his bill by making them parties.* Bogardus *v.* Rosendale Man. Co., 7 N. Y. 147.

[1] Cornwall *v.* Eastham, 2 Bush (Ky.), 561.

[2] 3 Mason (U. S.), 308.

[3] Erickson *v.* Nesmith, 15 Gray (Mass.), 221: *s. c.* 4 Allen (Mass.), 233.

other States, did not appear. The court held that it could not proceed to a decree against such as were residents of other States, nor could they be brought in by service of process unless they voluntarily chose to appear. Service on persons out of the jurisdiction could be made only in cases where such persons had a legal residence within the jurisdiction.[1] The rule that all parties in interest must be before the court was a rule of convenience, not of necessity. Where persons so interested were out of the jurisdiction of the court, and it was so stated in the bill and admitted by the answer, or proved, it was not necessary to make them parties; but a decree might be made as to those over whom the court had jurisdiction, if it could be made without injustice to those who were absent.[2] So, it is no objection to a bill filed by a receiver of a national bank, to enforce the statutory liability of shareholders, that stockholders named in the bill and averred to be without the jurisdiction of the court are not made defendants.[3]

§ **3496. All Stockholders Proper Parties.**—There is a well-understood distinction between *proper* parties and *necessary* parties in chancery practice; and, although we have discovered a great difference of judicial opinion upon the question as to whether it is *necessary* to join all the shareholders within the jurisdiction, in a creditors' bill against the corporation which seeks relief against them, there has never been any question that, in such an action, it is *expedient* and *beneficial*, and therefore *proper*, to join them when practicable.[4] And, as we have already seen, questions may be concluded against particular shareholders in the winding-up proceeding, where they are joined, which could not be concluded as against them unless they were so joined.[5]

[1] See Jermain *v.* Langdon, 8 Paige (N. Y.), 41; Evarts *v.* Becker, 8 Paige (N. Y.), 506.

[2] Erickson *v.* Nesmith, 46 N. H. 371.

[3] Kennedy *v.* Gibson, 8 Wall. (U. S.) 498.

[4] Wright *v.* Field, 7 Ind. 376; Overmyer *v.* Cannon, 82 Ind. 457.

[5] *Ante*, § 3482.

§ 3497. Not Necessary to Make Shareholders Defendants in Order to Secure Appointment of Receiver.—But it is settled that it is not necessary to make any of the shareholders defendants to the creditors' bill in order to secure the appointment of a receiver;[1] and accordingly it has been held that a judgment creditor's bill against a corporation and certain of its stockholders, which is dismissed as to all the defendants except the corporation, because of an omission to make all the stockholders parties, will stand as a judgment creditor's bill as to the corporation; and upon proper proceedings the complainant may have the right to the appointment of a receiver.[2]

§ 3498. Joint Action by a Single Creditor against All the Stockholders.—In Indiana there is a statute which is held to confer upon a single creditor the right to bring a joint action against all the stockholders.[3] This statute reads as follows: "That the stockholders of such corporation (whether the original signers of such articles of association, or the persons signing the same subsequently, or the person or persons to whom any shares of stock may be transferred or held under the regulations of such corporations) shall be liable, individually and jointly, to an amount equal to the stock held by them respectively."[4] The action is in the nature of an *equitable action*, and the judgment gives the plaintiff a decree for the entire amount, and apportions it among the stockholders according to their several holdings.[5]

§ 3499. Recent Theory that Stockholders are not Necessary Parties to a Winding-up Bill.—Within a recent period it has been held in the Supreme Court of the United States and in several State jurisdictions, that, in a proceeding in equity to wind up a corporation and to assess its stockholders so far as is necessary for the payment of its debts, it is not necessary to the validity of an assessment that the stockholders should be made parties; and hence, that it is no

[1] *Post*, § 3499. See, also, *post*, ch. 158, art. 4.

[2] Dunston *v.* Hoptonic Co., 83 Mich. 372; *s. c.* 47 N. W. Rep. 322.

[3] Overmeyer *v.* Cannon, 82 Ind. 457.

[4] Ind. Rev. Stat. 1881, § 3883.

[5] Overmeyer *v.* Cannon, *supra.*

defense on the part of a stockholder, when sued by the receiver to enforce the assessment, that the order of court by which it was made was in a proceeding to which he was not a party.[1] Nor does the fact that the corporation had, previously to the assessment, made an assignment for the benefit of its creditors, alter the case; since it still exists as a corporation for the purpose of enforcing its debts and collecting its assets,[2] — though this renders it necessary to make the trustees in the deed of assignment parties defendant.[3] The Supreme Court of Illinois have suggested a reason in support of this conclusion which seems unanswerable: "In order for the *board of directors* to have made a valid order for *payment*, it would not be contended, we presume, that defendant should have been before the *board*. No more, we conceive, was it necessary that defendant should have been before the *court*, when it, in place of the directors, made the call or order of assessment."[4] We do not understand that any of these decisions go to the length of holding that this principle cuts off any defense which particular stockholders may have, — as that they have paid in full,[5] or are not stockholders at all,[6] or the like. Thus, it has been well held that an *unequal assessment*, made by a court of another State, cannot be enforced by action in Wisconsin against a stockholder who was not a party to the proceeding in the other State.[7]

[1] Hawkins *v.* Glenn, 131 U. S. 319; Glenn *v.* Liggett, 135 U. S. 533; reversing *s. c.* 28 Fed. Rep. 907; Hamilton *v.* Glenn, 85 Va. 901; *s. c.* 9 S. E. Rep. 129; Howard *v.* Glenn, 85 Ga. 238; *s. c.* 11 S. E. Rep. 610; Vanderwerken *v.* Glenn, 85 Va. 9; *s. c.* 21 Am. & Eng. Corp. Cas. 526; 6 S. E. Rep. 806; 27 Cent. L. J. 386; 4 Rail. & Corp. L. J. 84; Great Western Tel. Co. *v.* Gray, 122 Ill. 630; *s. c.* 14 N. E. Rep. 214; reversing *s. c.* 23 Ill. App. 72. This case distinguishes Chandler *v.* Brown, 77 Ill. 333, as having been decided under a statute, and overrules Lamar Ins. Co. *v.* Gulick, 102 Ill. 41, which merely followed the last preceding case. The rule of the text was reaffirmed in Bates *v.* Great Western Tel. Co., 134 Ill. 536; *s. c.* 23 N. E. Rep. 521.

[2] Hawkins *v.* Glenn, Glenn *v.* Liggett, and Hamilton *v.* Glenn, *supra.*

[3] *Ibid.*

[4] Great Western Tel. Co. *v.* Gray, 122 Ill. 630, 640, opinion by Sheldon, J.; again quoted in Bates *v.* Great Union Tel. Co., 134 Ill. 536, 549.

[5] *Post,* § 3711.

[6] *Post,* § 3691.

[7] Great Western Tel. Co. *v.* Burnham, 79 Wis. 47; *s. c.* 24 Am. St. Rep.

§ 3500. Stockholders Must be Sued Separately at Law. — We have already seen that the liability of a stockholder, whether in respect of unpaid shares, or in respect of a superadded statutory liability, except where it is that of partners,[1] is *several, and not joint.*[2] As this liability is *unequal,* and as the liability of each particular stockholder depends upon a distinct contract subsisting between him and the corporation, it follows that, *in an action at law,* different stockholders cannot be joined as defendants except where they are liable as *partners.*[3] In Missouri, where the knowledge of the principles of equity procedure has been almost lost, under the influence of a code, it is held, for the same reasons, that each stockholder must be sued separately, whether at law or in equity.[4] The principle, as stated by the Supreme Court of Errors of Connecticut, and often judicially approved, is this: "Where a general statute, under which a corporation is organized, imposes a liability upon the stockholders in their individual capacity, in general terms, and in proportion to the amount of their stock, such liability is distinct from the corporate liability, and is of the same character as that incurred by an association of individuals where there is no corporate exist-

698. Where the holder of the notes of an insolvent bank, the stockholders of which are liable for so much of the just claims of creditors as remain unpaid after the assets of the bank shall be exhausted, filed a bill in equity to wind up the affairs of the institution under the provisions of its charter, and the stockholders were not made parties nor served with process, nor was any motion, petition, or prayer, filed to subject them to liability, it was held that so much of the final decree as discharged them from all liability for and on account of any debt or demand against them or the bank was *erroneous.* Terry *v.* Commercial Bank, 92 U. S. 454.

[1] *Ante,* § 3080.

[2] *Ante,* § 3086, *et seq.;* Crease *v.* Babcock, 10 Met. (Mass.) 525; Pratt *v.* Bacon, 10 Pick. (Mass.) 123, 127; Green *v.* Relf, 14 La. Ann. 841; Bank *v.* Ibbotson, 24 Wend. (N. Y.) 473; Ohio Life Ins. & Trust Co. *v.* Merchants' Ins. & Trust Co., 11 Humph. (Tenn.) 1, 33; *s. c.* 53 Am. Dec. 742; Pettibone *v.* McGraw, 6 Mich. 441; Lane *v.* Harris, 16 Ga. 217; Adkins *v.* Thornton, 19 Ga. 325, 328; 2 Mor. Priv. Corp., § 901; Pom. Rem., § 317.

[3] Paine *v.* Stewart, 33 Conn. 516; Abbey *v.* W. B. Grimes Dry Goods Co., 44 Kan. 415; *s. c.* 24 Pac. Rep. 426; Young *v.* New York & Liverpool U. S. Mail &c. Co., 15 Abb. Pr. (N. Y.) 69.

[4] Perry *v.* Turner, 55 Mo. 418; State Sav. Asso. *v.* Kellogg, 52 Mo. 583; *s. c.* 63 Mo. 540; 4 Cent. L. J. 332.

ence; and, although upon principle they should be subject to suit as in other cases of associate liability, yet, as such liability is peculiar, because unequal and limited, and a joint judgment against all is impossible, their liability must be treated as several, *ex necessitate rei*, and they must be sued severally."[1] An extension of the rule, which it is difficult to sustain on principle, is found in several decisions under bank charters in Georgia, where a separate action at law is allowed against each shareholder, although he is liable only for a *proportionate share* of the corporate debts,[2] a circumstance which ought, it should seem, to invoke the exclusive jurisdiction of equity.[3]

§ 3501. Except Where They are Liable as Simple Partners. — An exception to the foregoing rule exists where the governing statute makes (or leaves) the stockholders liable as simple partners, each one to an unlimited extent; and, as elsewhere seen,[4] this may happen under some theories,[5] though not under others,[6] where the coadventurers have *never become incorporated* by complying with the statutory conditions, but have nevertheless contracted in an assumed corporated name as though incorporated. Where the stockholders are thus liable as mere partners, the principles as to the necessity of joining all the defendants are those which are applied in the particular jurisdiction in other actions against partners. Take, for example, a case in Indiana, where the liability of the members of a *ditching association*, for manual labor performed in the construction of a ditch contemplated by their articles of association, was held to be *joint* and *not several*, and where it appeared that other members of the association not parties were within the jurisdiction. Here it was held that the action could not be maintained. The statute under which the association was formed provided

[1] Head-note in Paine *v.* Stewart, 33 Conn. 516. To the same effect is Gibbs *v.* Davis, 27 Fla. 531; *s. c.* 8 South. Rep. 633.

[2] Boyd *v.* Hall, 56 Ga. 563; Jones *v.* Wiltberger, 42 Ga. 575; Lane *v.* Harris, 16 Ga. 217.

[3] *Ante*, § 3416.

[4] *Ante*, § 3080.

[5] *Ante*, § 2969, *et seq.*

[6] Compare §§ 4133, 4135, 4136, 4318, *post.*

that all members should be personally liable for all debts contracted by the company for manual labor performed for it. The court reasoned that it would be different if the liability of the stockholders had been in *proportion* to the amount of stock held by them,[1] and that an individual liability of several persons for the same debt is a joint liability.[2]

§ 3502. Separate Actions to Enforce Limited Liability: Joint Actions to Enforce Unlimited Liability. — If, then, as is generally the case, the liability of stockholders is *limited* and *several*, — each one standing responsible for a definite sum, and no more, — and if, under the particular statute, the practice is established that an action at law will lie, then it is clear that a separate action may be brought against each one;[3] and unless the power of a court of law has been enlarged in the particular State, by statute, so that it may render a separate judgment against each of several defendants before it in one suit, accordingly as his liability may appear,[4] it is clear that stockholders thus liable at law must be separately sued.[5] If, however, the liability of the stockholders is primary and *unlimited*, like that of *partners*, all should be joined, for such an action is *quasi ex contractu*.[6]

[1] Citing Middletown Bank *v.* Magill, 5 Conn. 28.

[2] Shafer *v.* Moriarty, 46 Ind. 9. The ditching association in this case was said by the court to be "a corporation in fact," though it had no capital stock.

[3] Perry *v.* Turner, 55 Mo. 418; Bank of Poughkeepsie *v.* Ibbotson, 24 Wend. (N. Y.) 473; Boyd *v.* Hall, 56 Ga. 563; Jones *v.* Wiltberger, 42 Ga. 575; Lane *v.* Harris, 16 Ga. 217; Paine *v.* Stewart, 33 Conn. 516; Abbott *v.* Aspinwall, 26 Barb. (N. Y.) 202; Garrison *v.* Howe, 17 N. Y. 458, 463; Culver *v.* Third Nat. Bank, 64 Ill. 528.

[4] Such a statute exists in Tennessee, reading as follows: "Such and so many judgments, joint, separate, and cross, may be rendered as may be necessary to the rights of the parties." Stat. Tenn. 1871, § 2974.

[5] Bank of Poughkeepsie *v.* Ibbotson, 24 Wend. (N. Y.) 473; Perry *v.* Turner, 55 Mo. 418; Paine *v.* Stewart, 33 Conn. 516; Abbott *v.* Aspinwall, 26 Barb. (N. Y.) 202, 208.

[6] Allen *v.* Sewall, 2 Wend. (N. Y.) 327; Strong *v.* Wheaton, 38 Barb. (N. Y.) 616; Shafer *v.* Moriarty, 46 Ind. 9. But see Culver *v.* Third Nat. Bank, 64 Ill. 528, where the suit was against one only; and Dodge *v.* Minnesota Plastic Slate Roofing Co., 16 Minn. 368, where, under a statute of unlimited liability, an action was sustained against the corporation and

§ 3502 a. Rules on This Subject in Particular Jurisdictions. — The *New York* Code (and, it is presumed, other codes modeled upon it) provides that persons jointly liable on the same obligation or instrument, etc., may, any or all of them, be included in the same action, at the option of the plaintiff. This refers exclusively to demands evidenced by instruments of writing. It does not embrace a demand of laborers, for their wages, against the stockholders of a manufacturing company, under a statute making the latter liable to pay such wages; such demand not being so evidenced, though reduced to judgment against the corporation; consequently it is necessary to join all stockholders.[1] Under the New York Code of Procedure, it is not a misjoinder to sue two of four trustees of a corporation upon a joint and several liability. Where there is a several liability, the plaintiff may proceed against the defendants served, the same as though they were the only defendants. Where there is a joint liability, the plaintiff may obtain and enforce judgment against the property of such as are served, and against the joint property of all.[2] In *Pennsylvania*, while the corporation must be joined in an action by a creditor, under the law relating to manufacturing corporations,[3] yet if an officer of a corporation is proceeded against at law, on a special promise to pay a debt of the corporation, he must be sued separately as a guarantor; he cannot be joined with other members,[4] and the stockholders, or some of them, must be joined with the company.[5] In a proceeding by *garnishment*, under a statute of *Alabama*, by a judgment creditor of a corporation, to obtain satisfaction of his judgment out of the sums due the company by certain stockholders for their stock, it has been held that, although the liability of each stockholder is several, two or more of them may be summoned in the same writ, and this does not convert the process into a proceeding against joint debtors.[6] In *Mississippi*, although under the code,[7] each stockholder is severally liable to, and may be sued by, each judgment creditor

three of the stockholders. See, also, Reynolds *v.* Feliciana Steamboat Co., 17 La. 397, 407.

[1] Strong *v.* Wheaton, 38 Barb. (N. Y.) 616.

[2] Quigley *v.* Walter, 2 Sweeny (N. Y.) 175.

[3] Brightly's Purd. Dig. 998, § 30; Hoard *v.* Wilcox, 47 Pa. St. 51; Mansfield Iron Works *v.* Willcox, 52 Pa. St. 377.

[4] Youghiogeny Shaft Co. *v.* Evans, 72 Pa. St. 331.

[5] Mansfield Iron Works *v.* Willcox, 52 Pa. St. 377. See Patterson *v.* Wyomissing Co., 40 Pa. St. 117.

[6] Curry *v.* Woodward, 53 Ala. 371.

[7] Miss. Code, 1871, § 2413.

of the insolvent corporation, yet exceptional circumstances may justify suit by one against many, or by many against one or all.[1]

§ 3503. Summoning the Stockholder with the Corporation. — Statutory systems have existed, under which, in an action at law against the corporation, by the creditor, to establish and recover his debt, he is at liberty to summon the stockholders, or any of them, as co-defendants. Under such a statutory system in Massachusetts, the creditor might, by summoning a stockholder in his action against the corporation, have a judgment against both, and, keeping it alive by successive executions, have satisfaction from the stockholder if the corporation failed to satisfy it. But where he neglected to summon the stockholder, his demand became *merged* in his judgment against the corporation in such a sense that he could not bring a subsequent action upon it against the stockholder, and especially after the stockholder has ceased to be such.[2]

§ 3504. Whether Stockholder so Summoned can Contest the Merits. — The decisions of the Massachusetts court go no further than to deny that the statute in question interrupted the general rule which prohibited stockholders from appearing in suits against the corporation and contesting the merits, without first obtaining consent of the corporation, expressed in the regular mode named in its constitution or by-laws. This rule is founded in sound views of policy and convenience. If one member, or set of members, could appear and represent the corporation, any others might do the same; they might make different and inconsistent defenses, bind the corporation by their acts and admissions, against the will of the majority legally expressed, and thus lead to confusion and

[1] Vick *v.* Lane, 56 Miss. 681.

[2] Handrahan *v.* Cheshire Iron Works, 4 Allen (Mass.), 396. Compare Dodge *v.* Minnesota &c. Roofing Co., 16 Minn. 368, where it was held, under similar circumstances, that there was *no merger*, but that a subsequent action could be maintained against the stockholder upon a judgment obtained by him against the corporation.

conflict of rights.[1] The courts, however, are not uniform in this view. Thus, it has been held in Maine that a stockholder in a corporation against which a judgment has been recovered, and out of whose estate the execution issued thereon, has been satisfied, may bring error to reverse it.[2] This led to the conclusion, in a subsequent case, that a stockholder, when sued by a creditor upon a judgment rendered against the corporation, could not take advantage of a defect in the service of process in the original suit, unless he had availed himself of such defect in a direct proceeding to reverse the original judgment.[3]

§ **3505. Where Stock is Held by Partnership Firm.** — If a partnership owns stock in a corporation, whatever remedies the law gives against a stockholder may be enforced against any individual member of the partnership firm, for the reason that each member of a partnership is liable for the indebtedness of the firm. Thus, under a Missouri statute hereafter considered, the creditor may have an execution, upon his judgment against the corporation, against a single member of such a firm of stockholders, and it is not necessary to issue it against all. "Each member of a partnership," said Sherwood, C. J., "is liable for the indebtedness of the firm. The liability of the partners is joint and several, and we see no reason, founded in principle, why, in a proceeding like the present, one member of a firm may not be held answerable, as if he were sued in an ordinary action on the partnership

[1] Farnum *v.* Ballard Vale Machine Shop, 12 Cush. (Mass.) 507; Lane *v.* School District in Weymouth, 10 Met. (Mass.) 462. The corporation is one person and the stockholders are others. Therefore, an attachment sued out against the stockholders by name, without making the corporation a party, cannot be levied on the corporate property; and if so levied, it creates no lien as against a subsequent attaching creditor. Lillard *v.* Porter, 2 Head (Tenn.), 177.

[2] Merrill *v.* Suffolk Bank, 31 Me. 57; *s. c.* 50 Am. Dec. 649.

[3] Came *v.* Brigham, 39 Me. 35, 39. See Washington Bank *v.* Palmer, 2 Sandf. (N. Y.) 686; New York & Erie R. Co. *v.* Cook, 2 Sandf. (N. Y.) 732; Louisville R. Co. *v.* Letson, 2 How. (U. S.) 497, 554.

indebtedness, in which latter event no doubt could be entertained."[1]

ARTICLE III. THE CORPORATION AS A PARTY DEFENDANT.

SECTION
3509. When the corporation must be joined.
3510. Corporation a necessary party to suit to sequester unpaid subscriptions.
3511. Judgment against corporation and subsequent action against stockholder.
3512. Whether the corporation a necessary party to enforce a statutory individual liability.
3513. Corporation when a proper party in an action to enforce an individual liability.
3514. Right of corporation to appeal from order assessing stockholders.
3515. Conclusion: in equity all creditors, all shareholders, all adverse claimants, and the corporation should be joined.

§ **3509. When the Corporation must be Joined.** — If the proceeding is based on the original cause of action, and not on a judgment previously obtained against the corporation, there is good reason for holding that the corporation must be joined,[2] and it has been held that it should be joined in any event,[3] unless it is defunct.[4] Some of the statutes require or allow this; for instance, the repealed Massachusetts Act of 1862, chapter 218, section 4,[5] and the New York Act relating to plank-road companies;[6] and in Pennsylvania the same requirement is imposed, although the action is at law.[7] So,

[1] Bray *v.* Seligman, 75 Mo. 31, 40, 41. For a special contract of *indemnity* under which stockholders may be *separately sued*, see Taylor *v.* Coon, 79 Wis. 76; *s. c.* 48 N. W. Rep. 123.

[2] "The corporation should be joined, unless it has been dissolved or its assets wholly exhausted, for the reason that both creditors and stockholders are interested in closing its affairs, and in having its available property appropriated to the payment of debts, without which there can be no final settlement and adjudication of the rights and liabilities of the parties." Coleman *v.* White, 14 Wis. 700, 702; *s. c.* 80 Am. Dec. 797; *s. p.* Carpenter *v.* Marine Bank, 14 Wis. 705, note; Cleveland *v.* Marine Bank, 17 Wis. 545.

[3] Umsted *v.* Buskirk, 17 Ohio St. 113, 118.

[4] Wood *v.* Dummer, 3 Mason (U. S.), 308, 315.

[5] Supp. to Gen Stat. Mass. 1869–72, p. 173; Pope *v.* Leonard, 115 Mass. 286; Moore *v.* Reynolds, 109 Mass. 473.

[6] N. Y. Laws, 1847, ch. 210. See Conklin *v.* Furman, 48 N. Y. 527.

[7] Hoard *v.* Wilcox, 47 Pa. St. 51.

likewise, under the same statute,[1] they, or a portion of them, must be joined with the company.[2] But the general rule is that, unless specially authorized to do so by statute, stockholders cannot plead and defend for the corporation when the suit is against it, and they are not parties to the record.[3] There are two cases in which it is absolutely necessary that the corporation should be made a party defendant, and where the mere failure to raise the objection to its non-joinder, by demurrer or answer,[4] will not cure the defect. The first is, where the corporation still exists as a legal entity, — that is, where it has not been dissolved in point of law, though it may have suspended its functions and suffered a *de facto* dissolution, and the object of the bill is to secure the appointment of a *receiver* of its assets. Here, it must be joined, for the reason that, while it exists as a legal entity, it is the legal *owner* of the property sought to be impounded; and it would be contrary to all principle and a deprivation of property without due process of law, to take a man's property out of his hands and vest it in the hands of a *receiver*, in a proceeding to which he was not a party. The second case is, where the object of the bill is to assess shareholders who are beyond the reach of the process of the court, and where it is sought to bind them *by representation* through the corporation, under a recent theory already stated.[5] Here, of course, the corporation must be made a defendant. From these considerations it may be concluded that in no case can an action, whether at law or in equity, proceed *against the officers of the corporation alone*, without making either the corporation or the stockholders sought to be charged, parties defendant; and the author has met with no such case in his researches.

§ 3510. Corporation a Necessary Party to Suit to Sequester Unpaid Subscriptions. — Where the action is to sequester

[1] 2 Brightly's Purd. Dig. 998, § 30.

[2] Mansfield Iron Works *v.* Willcox, 52 Pa. St. 377.

[3] Bronson *v.* La Crosse R. Co., 2 Wall. (U. S.) 283; Holyoke Bank *v.* Goodman Paper Man. Co., 9 Cush. (Mass.) 576; Blackman *v.* Central R. Co., 58 Ga. 189; National Bank of Augusta *v.* Southern &c. Co., 55 Ga. 36.

[4] *Post*, § 3531.

[5] *Ante*, § 3393.

unpaid subscriptions for the benefit of the creditors of the corporation,[1] or to pursue and subject the assets of the corporation which it has distributed among its stockholders,[2]—the corporation is a necessary party; and this is of course so, where the theory of the action or of the court is such that all the assets of the corporation must be brought into administration.[3]

§ 3511. Judgment against Corporation and Subsequent Action against Stockholder.—In some jurisdictions judgment may be obtained against the corporation, and then a subsequent action at law may be brought against the stockholder. In such a case it is useless again to implead the corporation.[4]

§ 3512. Whether the Corporation a Necessary Party to Enforce a Statutory Individual Liability.—The general rule is believed to be, that the corporation is not a necessary party to an action to enforce a superadded statutory individual liability, but that the creditor, after he has exhausted his remedy against the corporation, under principles already stated,[5] and under some systems without exhausting such remedy,[6]—may proceed directly against the particular stockholder or stockholders sought to be charged.[7] And generally, where the liability created by the statute is a *several liability*, flowing directly from the stockholder to the creditor, it is neither necessary nor proper to implead the corporation as a defendant, unless the statute requires it; because the object of the action is to get a judgment against the stockholder, and no

[1] Wetherbee *v.* Baker, 35 N. J. Eq. 501.

[2] Swan Land &c. Co. *v.* Frank, 39 Fed. Rep. 456.

[3] Wetherbee *v.* Baker, 35 N. J. Eq. 501. See Coleman *v.* White, 14 Wis. 700; *s. c.* 80 Am. Dec. 797,—where it is said: "The corporation should be joined, unless it has been dissolved, or its assets wholly exhausted." As to the dissolution which may excuse such a joinder, see *ante*, § 3345, *et seq.*

[4] Reasoning in Nolan *v.* Hazen, 44 Minn. 478; *s. c.* 47 N. W. Rep. 155. See *ante*, §§ 3392, 3467, *et seq.*

[5] *Ante*, § 3351, *et seq.*

[6] *Ante*, § 3358.

[7] Nolan *v.* Hazen, 44 Minn. 478; *s. c.* 47 N. W. Rep. 155.

relief is sought against the corporation.[1] Thus, under statutes of Florida, already considered, upon the dissolution of a corporation a creditor can enforce the liability of a stockholder for the debts of the corporation, by suit directly against the stockholder, without joining the company or first exhausting his remedy at law against it;[2] and this is a type of many other statutes.[3]

§ 3513. Corporation When a Proper Party in an Action to Enforce an Individual Liability.—Under other theories the corporation is a *proper* party,—the plaintiff can proceed jointly against the corporation and the stockholders if he wishes in an action to enforce an individual liability on the part of the stockholders.[4] Thus, where the charter of a private corporation provided that all its stockholders should be jointly and severally liable to the nominal amount of their respective holdings of shares for its debts, and that any creditor whose demand had been presented to the proper officer for payment, and payment thereof refused, might sue any one or more of the stockholders,—it was held that he might, under the provisions of another statute,[5] file his bill in equity against the

[1] Perkins *v.* Church, 31 Barb. (N. Y.) 84.

[2] Gibbs *v.* Davis, 27 Fla. 531; *s. c.* 8 South. Rep. 633.

[3] Thus, under the Revised Statutes of Wisconsin, § 3223, the creditor may proceed against a shareholder without impleading the corporation, because the statute, in express terms, allows him to join the corporation at his election. Flour City Nat. Bank *v.* Wechselberg, 45 Fed. Rep. 547.

[4] Patterson *v.* Wyomissing &c. Co., 40 Pa. St. 117; Masters *v.* Rossie Lead Mining Co., 2 Sandf. Ch. (N. Y.) 301. Under a statute of Colorado providing that if any corporation shall dissolve or cease doing business, leaving debts unpaid, suits in equity may be brought against all persons who were stockholders at the time, by joining the corporation in such suit, and that each stockholder shall be liable for its debts to the extent of his unpaid stock (Gen. Stat. Col., § 212), a stockholder can be joined as a defendant with the company, and an original judgment rendered against him in a suit in equity, where the complaint alleges that the company has ceased to do business, leaving debts unpaid, and that it has dissolved its organization so far as it has power to do so. Tabor *v.* Goss &c. Man. Co., 11 Col. 419; *s. c.* 21 Am. & Eng. Corp. Cas. 650; *s. c.* 18 Pac. Rep. 537. And the same may be done in Wisconsin: Cleveland *v.* Marine Bank, 17 Wis. 545.

[5] 2 Rev. Stat. N. Y. 461.

company and such stockholders as he knew, for the purpose of charging them with payment of the debt, and might pray a *discovery* of the names and residences of the unknown stockholders, with the amount of stock held by them respectively, with a view to amend his bill and to make them parties,[1] under a rule already considered.[2] Even where the creditor proceeds against the stockholders in respect of their statutory superadded individual liability, and the rule of procedure in the particular jurisdiction requires a *general accounting* and adjustment of equities,—in other words, requires a general *winding-up bill*,[3]—then the corporation is a necessary party defendant, and unless it is joined the action cannot proceed,[4] unless there is a failure to make the objection in the proper mode,[5] as elsewhere stated.[6] And we have already seen that the inability to make the corporation a defendant for the purposes of such an accounting has been one of the grounds of repelling jurisdiction to proceed in equity against a stockholder in a State other than that of the domicile of the corporation.[7] It was said by Chancellor Walworth, in 1844, that "where the corporate property of a manufacturing corporation is all exhausted, and the bill is filed against the stockholders by a creditor of the company for the mere purpose of enforcing the personal liability of the stockholders for the debts of the company, it may not be necessary to make the corporation itself a party, although its dissolution has not been judicially declared."[8] And, as we have already seen, where a corporation is *ipso facto* dissolved, it is not necessary, as a *condition precedent* to the right of the

[1] Bogardus *v.* Rosendale Man. Co., 7 N. Y. 147, 151; citing Morgan *v.* New York &c. R. Co., 10 Paige (N.Y.), 290, 293; *s. c.* 40 Am. Dec. 244. This last-named case was a bill in equity to sequester what remained unpaid by the stockholders on their share subscriptions, and was therefore not in point on the precise question under consideration.

[2] *Ante*, § 3438.

[3] *Ante*, § 3470.

[4] Nimick *v.* Mingo Iron Works Co., 25 W. Va. 184.

[5] Umsted *v.* Buskirk, 17 Ohio St. 114, 118.

[6] *Post*, § 3531.

[7] *Ante*, § 3055, *et seq.*

[8] Mickles *v.* Rochester City Bank, 11 Paige (N. Y.), 118; *s. c.* 42 Am. Dec. 103, 106.

creditor to proceed against its stockholders, that he should have recovered a judgment against it, for the law does not require him to do a vain thing.[1] For the same reasons, where the corporation has sold every thing except its right to exist as a corporation, and has no officers or place of business, it is not a necessary party to a suit against a stockholder to make him liable for his unpaid subscription, though it may have power to reorganize and collect the stockholder's dues.[2]

§ 3514. Right of Corporation to Appeal from Order Assessing Stockholders. — Since, according to the modern theory,[3] the various stockholders need not be made parties to a general winding-up bill in equity, but are deemed to be *represented* by the corporation, it logically follows that it is the duty of the corporation to protect their interests in the litigation; and it also follows that where an order is made in such a proceeding directing the receiver to bring actions against the stockholders, the corporation may appeal from such an order, on behalf of its stockholders who are not parties to the suit, provided the order is otherwise appealable under the rules of procedure applicable in the forum.[4]

§ 3515. Conclusion: In Equity, All Creditors, All Shareholders, All Adverse Claimants, and the Corporation should be Joined. — Without doubt, the sound rule of *equity procedure* applicable to such cases, and to be enforced within reasonable and practicable limits, has been laid down by the Supreme Court of Wisconsin: All the creditors should join, or one or more of them should sue for the benefit of all. The

[1] *Ante*, § 3367, *et seq.*

[2] Wellman *v.* Howland Coal & Iron Works, 19 Fed. Rep. 51.

[3] *Ante*, § 3499.

[4] Republic Life Ins. Co. *v.* Swigert, 135 Ill. 150; *s. c.* 25 N. E. Rep. 680. In this case an order of court was made directing the payment of a certain dividend to creditors. On this order the receiver paid out a large sum in good faith. There was no objection to the order. The court said: "The order was a final and an appealable order, but no appeal was taken or writ of error sued out until after the entry of the final decree in the cause." And the court therefore held that it would not consider objections to it, but that it ought to stand for the protection of the receiver.

action should be brought against the corporation and all the stockholders, unless it be impracticable to bring them all before the court, or some other sufficient cause for the omission be shown. Unless the action is founded upon a judgment at law previously obtained against the corporation, and perhaps in any event, the corporation should be joined. "The creditors should all join, because they have a common interest in the funds to be realized; or, if the action be commenced by one or more of them, the complaint should be so framed that the others may come in and prove their claims before the court or a referee, and share in the distribution of the moneys received. All the stockholders should be made defendants; because they, too, have a common interest, and without their presence it is impossible to adjust their rights and liabilities, and protect them from unequal and oppressive burdens. The same reasons exist for making all the stockholders parties to such actions, as in proceedings against delinquent stock subscribers to compel them to contribute toward the payment of the debts of an insolvent bankrupt corporation. The corporation should be joined, unless it has been dissolved, or its assets wholly exhausted, for the reason that both creditors and stockholders are interested in closing its affairs, and in having its available property appropriated to the payment of debts, without which there can be no final settlement and adjudication of the rights and liabilities of the parties."[1] A still more comprehensive statement of the doctrine makes *all adverse claimants of the common fund parties defendant.* 1. All creditors consenting should be joined as plaintiffs. 2. All creditors claiming the right to maintain separate actions at law should be joined as defendants, for the purpose of enjoining such actions at law. 3. If the assets of the corporation have passed into the hands of an assignee, not entitled to hold them as against the creditors, proceeding in a general winding-up bill, this assignee must also be joined.

[1] Coleman *v.* White, 14 Wis. 700, 702; *s. c.* 80 Am. Dec. 797, *per* Dixon, C. J.; *s. p.* Carpenter *v.* Marine Bank, 14 Wis. 705, note; Cleveland *v.* Marine Bank, 17 Wis. 545. So held in Mann *v.* Pentz, 3 N. Y. 415.

4. The corporation must necessarily be joined, because the equitable assets sought to be sequestered are its property, and a man's property cannot be disposed of, without his consent, in a proceeding to which he is not a party.[1]

[1] This last comprehensive statement is brought out by the decision of the New York Court of Appeals in Pfohl *v.* Simpson, 74 N. Y. 137. In this case the assets of the corporation had passed into the charge of an *assignee under the Federal Bankrupt Law*, and he was made a party defendant; though on what grounds a State court could claim jurisdiction of the assets of the insolvent corporation after they had passed into the hands of an assignee under the Federal law was not made to appear in the opinion, though the point was raised by counsel, as is shown by the briefs. In fact, the opinion was silent on the question.

CHAPTER LXIII.

PROCEEDINGS IN EQUITY.

ART. I. NATURE AND INCIDENTS OF CREDITORS' BILLS IN SUCH CASES. §§ 3518-3523.
II. QUESTIONS OF PLEADING AND PROCEDURE. §§ 3526-3533.
III. THE RELIEF GRANTED. §§ 3536-3545.

ARTICLE I. NATURE AND INCIDENTS OF CREDITORS' BILLS IN SUCH CASES.

SECTION
3518. Nature of a creditor's bill in such cases.
3519. This distinction under the statutes of New York and Wisconsin.
3520. Auxiliary relief by injunction.
3521. Necessity of a judgment at law.
3522. Creditors need not first endeavor to induce corporation to sue.

§ 3518. Nature of a Creditor's Bill in Such Cases. — The general nature of a creditor's bill in such cases is suggested by the statement that a judgment creditor of a corporation, whose execution has been returned *nulla bona*, may bring a suit in equity, on behalf of himself and all other creditors, against the corporation and such of its shareholders as may conveniently be made defendants, for an accounting, for the purpose of ascertaining the amount due and unpaid in respect of their shares of stock, to the end that it may be laid hold of by the court and applied to the satisfaction of the demands of the creditors of the corporation.[1] Such a bill, filed against the stockholders of a corporation, alleging its insolvency, the personal liability of the stockholders, and the fact that many

[1] Bronson *v.* Wilmington &c. Life Ins. Co., 85 N. C. 411.

creditors are proceeding by separate suits at law, thus wasting the assets, states a case for equitable relief.[1]

§ 3519. This Distinction Under the Statutes of New York and Wisconsin.—The statutes of New York,[2] of Wisconsin,[3] and probably those of some other States, provide for a proceeding supplementary to execution, in the nature of a creditor's bill. The statutes of Wisconsin, in another chapter, provide for a proceeding on behalf of judgment creditors of corporations for the sequestration of their assets.[4] The difference between these two statutes consists in the fact that the creditor who proceeds by creditor's bill, or by the statutory proceedings in the nature of a creditor's bill, gets a preference over other creditors. The vigilant creditor acquires, by the filing of his bill, a *lien*, equivalent to an actual levy, upon all the equitable assets of the debtor, and this lien is not displaced or impaired by subsequent proceedings instituted by other creditors,[5] even though their

[1] Tunesma *v.* Schuttler. 114 Ill. 156. Further, as to the nature of the creditor's bill in such cases, see Thompson *v.* Reno Sav. Bank, 19 Nev. 103; *s. c.* 3 Am. St. Rep. 797. As to the *flexibility* and *scope* of the remedy, see Arthur *v.* Willius, 44 Minn. 409, 412; Ballin *v.* Loeb, 78 Wis. 404, 412; *s. c.* 47 N. W. Rep. 516; 10 L. R. A. 742.

[2] 5 Edmond's Stat. at Large, 83, § 292. See Dean *v.* Biggs, 25 Hun (N. Y.), 122.

[3] Rev. Stat. Wis. 1858, ch. 134, § 88; 2 Taylor's Wis. Stat. 1564, § 100; *Ibid.*, 1566, § 103; Laws Wis. 1860, ch. 303, §§ 1, 2; 2 Taylor's Wis. Stat. 1568, §§ 112, 113.

[4] 2 Taylor's Wis. Stat. 1732, §§ 18, 19. "Whenever a judgment shall be obtained against any corporation incorporated under the laws of this State, and an execution issued thereon shall have been returned unsatisfied, in whole or in part, upon the petition of the person obtaining such judgment, or his representatives, the circuit court within the proper county may sequestrate the stock, property, things in action, and effects of such corporation, and may appoint a receiver of the same. In the final order on any such, the court shall direct a just and fair distribution of the property of such corporation, and of the proceeds thereof, to be made among the fair and honest creditors of such corporation, in proportion to their debts respectively, who shall be paid in the same order as provided in the case of a voluntary dissolution of a corporation."

[5] 2 Wait's Act. & Def. 428; Storm *v.* Waddell, 2 Sandf. Ch. (N. Y.) 494; Brown *v.* Nichols, 42 N. Y. 26; Lynch *v.* Johnson, 48 N. Y. 27; George *v.* Williamson, 26 Mo. 190; *s. c.* 72 Am. Dec. 203; McCalmont *v.* Lawrence, 1 Blatchf. (U. S.) 232. Compare Roberts *v.* Albany &c. R. Co., 25 Barb. (N. Y.) 662; Edmeston *v.* Lyde, 1

judgments are older than his.[1] But the statute giving the proceeding against corporations provides for a ratable distribution of the assets among creditors. Both of these statutes being in existence, can the creditor of a corporation proceed under the former and acquire a preference? Or, the latter statute only being in existence, can he acquire a like preference by filing a creditor's bill? It has been held in New York that he must proceed under the latter statute on behalf of himself.[2] But in Wisconsin, the view has been taken that he may proceed under the former statute, this being the cheaper and more direct mode, until some other creditor, proceeding under the latter section, procures an injunction against the prosecution of his suit, as therein provided.[3] But the safer and more preferable course is for the creditor to bring a petition under the latter statute, on behalf of himself and all other creditors who may choose to join in the action;[4] and if he has commenced his proceeding under the former statute, he should amend his complaint by setting forth that the proceeding is in behalf of all creditors, and making all stockholders parties.[5] But, unless some other proceeding is given by statute, there is no doubt that the form of suit in equity known as a *creditor's bill*, although regulated by statute, is an appropriate proceeding.[6]

Paige (N. Y.), 637; *s. c.* 19 Am. Dec. 454; Wakeman *v.* Grover, 4 Paige (N. Y.), 23; *s. c.* affirmed, 11 Wend. (N. Y.) 187; 25 Am. Dec. 624.

[1] Lyon *v.* Robbins, 46 Ill. 276. *Contra*, State Savings Asso. *v.* Kellogg, 63 Mo. 540.

[2] Morgan *v.* New York &c. R. Co., 10 Paige (N. Y.), 290; *s. c.* 40 Am. Dec. 244; Sherwood *v.* Buffalo &c. R. Co., 12 How. Pr. (N. Y.) 136; Hinds *v.* Canandaigua &c. R. Co., 10 How. Pr. (N. Y.) 487; Courtois *v.* Harrison, 12 How. Pr. (N. Y.) 359; *s. c.* 3 Abb. Pr. (N. Y.) 96; 1 Hilt. (N. Y.) 109.

[3] Ballston Spa Bank *v.* Marine Bank, 18 Wis. 490; Pierce *v.* Milwaukee Construction Co., 38 Wis. 253. See Courtois *v.* Harrison, 12 How. Pr. (N. Y.) 359; *s. c.* 3 Abb. Pr. (N. Y.) 96; 1 Hilt. (N. Y.) 109; Lowber *v.* Mayor, 5 Abb. Pr. (N. Y.) 268; 7 Abb. Pr. (N. Y.) 248; McBride *v.* Farmers' Bank, 28 Barb. (N. Y.) 476; *s. c.* 7 Abb. Pr. (N. Y.) 347; Rankine *v.* Elliott, 16 N. Y. 377.

[4] Adler *v.* Milwaukee Patent Brick Co., 13 Wis. 57.

[5] Pierce *v.* Milwaukee Construction Co., 38 Wis. 253.

[6] Miers *v.* Zanesville Co., 11 Ohio, 273; *s. c.* 13 Ohio, 197; Henry *v.* Vermillion Co., 17 Ohio, 187; Marsh *v.* Burroughs, 1 Wood (U. S.), 463, 467. The distinction between *supplementary proceedings* given by statute in the

§ **3520. Auxiliary Relief by Injunction.**—Where the bill proceeds *in behalf of all the creditors*, and there will not be enough for all after assessing the stockholders to the full extent to which they are liable, it is *necessary to justice* that the prosecution of separate actions by particular creditors should be enjoined; otherwise they would get unjust advantages over the creditors who join in the equity suit.[1] But such an injunction cannot be granted where the right of the creditor to prosecute a separate suit at law is a *clear statutory right*.[2] It has been held that such an injunction ought to go to restrain a separate creditor from prosecuting an action commenced after the making of an order appointing a receiver, but before the appointment has been perfected.[3] But, as the receiver succeeds to the right of the corporation, the enjoining of actions commenced by the corporation does not necessarily follow; and accordingly, where an action for an unpaid stock subscription has been commenced *by the company*, and a receiver is afterwards appointed, the action may be *continued in the name of the company*.[4] But a receiver of an insolvent corporation cannot interfere in an action *against it* until he has been

same action, and creditors' bills, is further explained and illustrated in Allen *v.* Benton, 79 Mo. 165, 166; Irons *v.* Manufacturers' Nat. Bank, 17 Fed. Rep. 308; Bronson *v.* Wilmington &c. Life Ins. Co., 85 N. C. 411, 413. And see as to supplemental proceedings in North Carolina, Rand *v.* Rand, 78 N. C. 12; Carson *v.* Oates, 64 N. C. 115; McKeithan *v.* Walker, 66 N. C. 95; Hutchison *v.* Symons, 67 N. C. 156; Rankin *v.* Minor, 72 N. C. 424.

[1] Ballin *v.* Loeb, 78 Wis. 404; *s. c.* 47 N. W. Rep. 516; 10 L. R. A. 742; Rankine *v.* Elliott, 16 N. Y. 377; affirming *s. c.* 14 How. Pr. (N. Y.) 339; Eames *v.* Doris, 102 Ill. 350; Geery *v.* New York &c. Steamship Co., 12 Abb. Pr. (N. Y.) 268; Pfohl *v.* Simpson, 74 N. Y. 137. To this end those creditors who persist in prosecuting separate actions at law must, of course, *be made parties defendant* to the suit in equity. See the case last cited.

[2] Mason *v.* New York Silk Man. Co., 27 Hun (N. Y.), 307. And see, also, Mathez *v.* Neidig, 72 N. Y. 100, where it was held, under the same statute, the New York Manufacturing Act (N. Y. Laws of 1848, ch. 40, sec. 12), that the creditor had *his election* either to proceed at law against any stockholder, or in equity against all the stockholders.

[3] Rankine *v.* Elliott, 16 N. Y. 377; affirming *s. c.* 14 How. Pr. (N. Y.) 339.

[4] Phœnix Warehousing Co. *v.* Badger, 67 N. Y. 294, 299.

made a party by order of the court.[1] An injunction cannot be granted so as to displace *legal liens* acquired by a particular creditor prior to the filing of the general creditors' bill, unless there is some statute—such as the late Federal Bankruptcy Law—ascribing such an effect to the winding-up proceeding; or, at least, if the prosecution of suits in which such liens have been established are enjoined, the injunction will not have the effect of discharging the liens; but the liens acquired by *attaching, judgment*, or *execution* creditors, will be entitled to *preference* in their order, in the decree of final distribution.[2] It is equally plain that, in order for a general creditors' bill to do effectual justice, an injunction should go *against the officers* who wield the power of the corporation, and perhaps also in point of form merely *against the corporation* itself, restraining them from further meddling with its assets or dealing with its creditors. Thus, it has been held that an order appointing a *receiver* of the assets of an insolvent corporation for the purpose of winding up its affairs, should contain a clause restraining its *officers* from paying the debts, or paying away or transferring the assets.[3] It is scarcely necessary to add that equity will grant this species of relief according to the demands of justice in each particular case, and so will a court of *bankruptcy* wielding the powers of a court of equity.[4]

§ **3521. Necessity of a Judgment at Law.**—Regularly, as already seen,[5] the creditor must, before invoking the aid of

[1] Tracy *v.* First Nat. Bank, 37 N. Y. 523.

[2] Minchin *v.* Second Nat. Bank, 36 N. J. Eq. 436. See the observations of Leonard, J., in Geary *v.* New York &c. Steamship Co., 12 Abb. Pr. (N. Y.) 268, where the general doctrine that the creditors who proceed in equity are entitled to an injunction against separate suits at law is qualified.

[3] Morgan *v.* New York &c. R. Co., 10 Paige (N. Y.), 290; *s. c.* 40 Am. Dec. 244. But an injunction depriving the officers of a corporation of the control of all its property should not, it has been held, be granted *ex parte* on the certificate of a vice-chancellor or an injunction master out of court. *Ibid.*

[4] Gibson *v.* Lewis, 11 N. B. R. 247. Case where the corporation was in bankruptcy, and a temporary injunction to restrain general distribution was refused, but an injunction to restrain temporarily a disposition of the corporate stock was granted. Gibson *v.* Lewis, 11 Phila. (Pa.) 476.

[5] *Ante*, § 3351.

equity, have exhausted his remedy at law; and the usual proof of his having done so is the recovery of a *judgment* and the return of an *execution nulla bona.*[1] It must then be regarded as a general rule, in the absence of statutory exceptions, that the creditor cannot proceed against the stockholder until he has obtained a judgment at law.[2] The construction of statutes, or other judicial theory, has dispensed with this necessity in some jurisdictions. Thus, under a statute of Wisconsin in force in 1863, a creditor of a corporation might proceed by bill in equity, in behalf of himself and all other creditors who might choose to make themselves parties, against the corporation, jointly with its stockholders, without first obtaining a judgment at law;[3] and the same was and still is the rule in Alabama;[4] and is the rule under some theories where the stockholders are jointly and severally liable as *partners* for the whole amount of the debt, without reference to the amount of stock owned; here there may be a decree against them, even before a decree is had against the corporation.[5] In Massachusetts it was not necessary to obtain a judgment at law as a prerequisite to maintaining a bill *against the directors*, under a statute making them liable for incurring debts in excess of the capital stock, the company becoming insolvent.[6]

[1] *Ante*, § 3357.

[2] *Ante*, § 3354; Blake *v.* Hinkle, 10 Yerg. (Tenn.) 218; Cambridge Water Works *v.* Somerville Dyeing Co., 4 Allen (Mass.), 239.

[3] Cleveland *v.* Marine Bank, 17 Wis. 545.

[4] Smith *v.* Huckabee, 53 Ala. 191. See, also, Central Agricultural &c. Asso. *v.* Alabama Gold Life Ins. Co., 70 Ala. 120, where the creditor who filed the bill proceeded for the residue of a debt left unsatisfied after foreclosing a mortgage, and without having reduced his demand to a judgment at law, so far as appears.

[5] Masters *v.* Rossie &c. Co., 2 Sandf. Ch. (N. Y.) 301.

[6] Merchants' Bank *v.* Stevenson, 5 Allen (Mass.), 398. The court, referring to the case of Merchants' Bank *v.* Stevenson, 10 Gray (Mass.), 232, says that it was held in that case, under the statute quoted, that a suit at law against the directors could not be maintained, but that the only proper remedy was by bill in equity, in which all the creditors entitled to a remedy against the *directors* could join, the amount of their debts be ascertained, the excess of such debts above the capital stock determined and adjudicated, and a just and proper apportionment made of the amount assessed among the several creditors in proportion to the amount of their

§ 3522. Creditors need not First Endeavor to Induce Corporation to Sue. — It is not a *condition precedent* to the right of the creditor to maintain a suit in equity against the corporation and a shareholder, to subject what is due from the shareholder to the corporation in respect of his shares, that the creditor should first have made an effort to induce the corporation to make a *call* on the shareholder for so much of what is due from him in respect of his shares as will be necessary to satisfy the creditor's judgment. This question has no analogy to those decisions which hold that a stockholder or creditor may, under certain circumstances, and to prevent a failure of justice, institute and control a suit in his own name involving the rights of the corporation, if it has refused to take action.[1]

Article II. Questions of Pleading and Procedure.

Section
3526. Questions of pleading in such creditors' bills.
3527. Multifariousness.
3528. Issues not determined by original complaint.
3529. Not necessary to give stockholders fresh notice of claims of creditors subsequently coming in, in order to support judgments by default.

Section
3530. Averments to excuse the bringing in of insolvents and non-residents.
3531. Objection for want of parties when waived.
3532. Joining an action to enforce unpaid subscriptions with an action to enforce individual liability.
3533. Stockholders not permitted to sever in their defenses.

§ 3526. Questions of Pleading in Such Creditor's Bill. — Such a bill is not demurrable on the ground that it fails to set out the number of shares held by each defendant, and to state what residue of the subscription of each defendant remains unpaid, where it states that the plaintiffs are unable to get this information, and that they demand a *discovery* thereof. "It is sufficient to charge that each owes upon his

respective debts. It did not determine that a judgment at law must first be recovered against the corporation, before such suit in equity could be commenced to enforce the liability of the directors.

[1] Thompson *v.* Reno Sav. Bank, 19 Nev. 171; *s. c.* 3 Am. St. Rep. 881.

stock subscription, and should pay up what is still due, at least so far as to satisfy the claims of creditors of the corporation." [1] Where the creditor has not prosecuted his claim to judgment against the corporation, the company may, it has been held, file a *cross-bill*, setting up a defense which it might have interposed to the creditor's action at law.[2] And even where the creditor has prosecuted his demand to a judgment at law, the corporation may, it has been held, file a cross-bill setting up any matter which it was not obliged to litigate in the action at law, — as, for instance, a counterclaim founded on the breach by the complainant of a contract to take its stock.[3]

§ **3527. Multifariousness.** — Every equity pleader is aware that no fixed rule can be laid down by which to determine whether a given bill is or is not obnoxious to the objection of multifariousness. It may be stated that, for the purpose of preventing a multiplicity of suits, a court of equity will retain a bill claiming one general right against several defendants, although there be no privity of interest between them, and although each may stand in a different relation to the complainant from the others.[4] Chancellor Kent sustained a bill the object of which was to set aside fraudulent conveyances of corporate property, as well as to coerce payment of defaulting stockholders; but he appears to have rested his conclusion on the ground that all the defendants were charged with fraudulent practices, though in different degrees;[5] and the Supreme Court of Alabama sustained a bill of the same nature, although it was admitted that the stockholders, as such, had no concern

[1] Bronson *v.* Wilmington &c. Ins. Co., 85 N. C. 411, 414.

[2] Quick *v.* Lemon, 105 Ill. 578.

[3] *Ibid.*

[4] Whaley *v.* Dawson, 2 Sch. & Lef. 367; York *v.* Pilkington, 1 Atk. 282. See further, *post,* ch. 183.

[5] Brinkerhoff *v.* Brown, 6 Johns. Ch. (N. Y.) 139. The general doctrine of this case, namely, that "a bill may be filed against several persons relative to matters of the same nature, forming a connected series of acts, all intended to defraud and injure the plaintiffs, and in which all the defendants were more or less concerned, though not jointly in each act," was recognized and applied in Fellows *v.* Fellows, 4 Cow. (N. Y.) 682; *s. c.* 15 Am. Dec. 412.

in the allegations of fraud affecting the deed of conveyance sought to be set aside. The decision was placed upon the ground that the object of the bill was single, namely, to reach *equitable assets* of the corporation, in satisfaction of the complainant's judgment at law; and it was thought to create no difficulty that these assets were of two kinds, namely, (1) those arising from the right of the corporation to call in its unpaid stock, and (2) those which might be produced by setting aside the alleged fraudulent conveyance.[1]

§ 3528. **Issues not Determined by Original Complaint.** — Considering the flexible nature of the creditor's bill as explained in a previous section,[2] it has been held that, in order to ascertain whether the individual liability of the stockholders is properly enforceable in the proceeding, regard must be had, not merely to the complaint of the original plaintiffs, but also to the issues tendered by the pleadings of other creditors who may afterwards come in; and it is immaterial by what particular name they designate their pleadings, — whether answers, complaints, or cross-bills.[3] The meaning is, that the issues are not fixed by the bill of the creditors who first institute the proceeding, but that the proceeding is so flexible as to admit of other issues, raised by the petitions of other intervening creditors, and the defensive pleadings thereto.

§ 3529. **Not Necessary to Give Stockholders Fresh Notice of Claims of Creditors Subsequently Coming in, in Order to Support Judgments by Default.** — Where the proceeding is brought in the form of a general creditor's bill, in behalf of all stockholders who may come in, and against the corpora-

[1] Allen *v.* Montgomery R. Co., 11 Ala. 437, 447. Examples of such *bills held multifarious:* Cambridge Water Works Co. *v.* Somerville Dyeing Co., 14 Gray (Mass.), 193; Pope *v.* Leonard, 115 Mass. 286; Ohio Life Ins. &c. Co. *v.* Merchants' Ins. &c. Co., 11 Humph. (Tenn.) 1; *s. c.* 53 Am. Dec. 742. Examples of such bills held *not multifarious:* Burns *v.* Beck, 83 Ga. 471; *s. c.* 10 S. E. Rep. 121; Pope *v.* Salamanca Oil Co., 115 Mass. 286, 290.

[2] *Ante,* § 3433.

[3] Arthur *v.* Willius, 44 Minn. 409, 413.

tion and all shareholders who can be found, to sequester all the assets of the corporation, including so much of what is due by the shareholders upon their share subscriptions, as may be necessary for the purpose of satisfying its debts,—it is not necessary to give to the stockholders successive notice of the claims of those creditors who successively come in and prefer their demands; and it will not be a good objection to a judgment by default rendered against a particular shareholder that he had no notice other than the original summons; since he is bound to take notice of the general scope of the proceeding, and of the fact that other creditors may come in and prefer their demands.[1]

§ 3530. Averments to Excuse the Bringing in of Insolvents and Non-residents. — Where the rule of the statute or of the jurisdiction requires all the shareholders to be made parties defendant, except where it is useless or impossible to bring them all in, the plaintiff creditors should so frame their bill, by appropriate averments, as to excuse their failure to join as parties defendant those stockholders who are insolvent or non-resident; and if it appears that all the stockholders are not brought in, and if, at the same time, the bill contains no such averments, a demurrer to it ought to be sustained.[2]

§ 3531. Objection for Want of Parties, when Waived. — In a proceeding in equity, or under the codes in the nature of a suit in equity, an objection for the non-joinder of the corporation,[3] or of other stockholders,[4] is *waived, unless taken by demurrer or answer;* it cannot be raised after the merits have been litigated.[5] The non-joinder of stockholders in actions

[1] Spooner *v.* Bay St. Louis Syndicate, 47 Minn. 464; *s. c.* 50 N. W. Rep. 601. That *creditors* entitled to come in and be made parties are not entitled to notice, but are bound by *representation*, see *ante*, § 3499.

[2] Friend *v.* Powers, 93 Ala. 114; *s. c.* South. Rep. 392. And see Bronson *v.* Wilmington &c. Life Ins. Co., 85 N. C. 411.

[3] Potter *v.* Dear, 95 Cal. 578; Umsted *v.* Buskirk, 17 Ohio St. 114; Leucke *v.* Tredway, 45 Mo. App. 507.

[4] Arthur *v.* Willius, 44 Minn. 409; *s. c.* 46 N. W. Rep. 851.

[5] Leucke *v.* Tredway, 45 Mo. App. 507, 516.

to charge the stockholders with the payment of corporate debts is taken advantage of in various ways, according to the practice, statutory or otherwise, prevailing in the particular jurisdiction. In Massachusetts, under a statute, the objection that all the stockholders in a corporation are not made defendants in a bill in equity, to charge the stockholders for the corporate debts, must be taken by plea or answer; it cannot be taken by demurrer, although the bill shows that not all of the stockholders are joined.[1] In an action at law, under the common-law system, it stood on the same footing as the case of the non-joinder of a *partner*, and was taken advantage of by a *plea in abatement;* otherwise the defect of parties was waived.[2] Under the Louisiana system, the objection was raised by *exception or plea;*[3] while under the code of New York,[4] and other similar codes,[5] the objection is waived, if not taken by demurrer or answer; and, if any of the stockholders joined as parties are not served or brought into court, the defect is waived if the others go to trial on the merits without applying to have the cause stayed until their associates are brought in.[6] If the objection is seasonably made by those stockholders who are brought in, it may afford a good ground for the court, master, or referee, to order the cause to stand over until the other parties are brought in.[7] If after such an order of postponement or continuance, the plaintiff unreasonably delays bringing in the other stockholders, it would seem to be good ground for dismissing his bill.[8]

[1] Essex Company *v.* Lawrence Machine Shop, 10 Allen (Mass.), 352.

[2] Allen *v.* Sewall, 2 Wend. (N. Y.) 327.

[3] Reynolds *v.* Feliciana Steamboat Co., 17 La. 397, 407.

[4] Strong *v.* Wheaton, 38 Barb. (N. Y.) 623.

[5] Arthur *v.* Willius, 44 Minn. 409; *s. c.* 46 N. W. Rep. 851.

[6] Arthur *v.* Willius, *supra.*

[7] *Ibid.* See Northwestern &c. Co. *v.* Norwegian &c. Seminary, 43 Minn. 449; *s. c.* 45 N. W. Rep. 868.

[8] See Johnson *v.* Robinson, 20 Minn. 170. In all jurisdictions, and in all forms of proceeding against stockholders, the rulings are that the objection for want of necessary parties must be specially raised *in some form of pleading:*—in a suit in equity, by *plea or answer:* Essex Co. *v.* Lawrence Machine Shop, 10 Allen (Mass.), 352; in an action at common law, by *plea in abatement:* Allen *v.* Sewall, 2 Wend. (N. Y.) 327; under Civil Code of Louisiana by *exception or plea:* Reynolds *v.* Feliciana Steamboat Co., 17

§ 3532. Joining an Action to Enforce Unpaid Subscriptions with an Action to Enforce Individual Liability.—Under some systems, a judgment creditor of an insolvent corporation may join, in the same action, a claim to compel payment of unpaid subscriptions for stock, and a claim to enforce the individual liability of stockholders, for the satisfaction of his judgment.[1]

§ 3533. Stockholders not Permitted to Sever in their Defenses.—It follows that the stockholders cannot be permitted to *sever* in their defenses, one of them defending by demurrer, and the others by answer. "To allow a severance in the mode of defense would let in all the inconveniences which the rule of the common law in regard to the practice by which *double pleading* is not allowed, was intended to exclude. For illustration: If the demurrer of the defendant Kidder be disposed of, that will decide the merits of the case, and the defendants De Rossett and others will not have had an opportunity of being heard by counsel. If the demurrer should be overruled, the case will in effect be decided against them, and if it be sustained, the case will be dismissed as to Kidder, and they will be left in an anomalous condition."[2]

ARTICLE III. THE RELIEF GRANTED.

SECTION
3536. Form of relief.
3537. Ordering an assessment upon the stock.
3538. Order of assessment not granted until general assets exhausted.

La. 397, 407; and, under the New York and Wisconsin Codes of Procedure, by *demurrer or answer:* Strong *v.* Wheaton, 38 Barb. (N. Y.) 616; Arthur *v.* Willius, 44 Minn. 409; *s. c.* 46 N. W. Rep. 851. Such is the rule under the Missouri Code of Procedure (R. S. Mo. 1889, §§ 2043, 2047), under which an objection for defect of parties is *waived,* if not taken by *demurrer or answer.* Michael *v.* St. Louis &c. Ins. Co., 17 Mo. App. 23; Hagar *v.* Graves, 25 Mo. App. 164; Pike *v.* Martindale, 91 Mo. 268. The rule extends even to the objection that there has been a *misjoinder* of parties, and reaches to the objection that the defendants were *improperly joined.* Anderson *v.* McPike, 41 Mo. App. 328; Taber *v.* Wilson, 34 Mo. App. 89.

[1] Warner *v.* Callender, 20 Ohio St. 190.

[2] Von Glahn *v.* De Rossett, 76 N. C. 292.

SECTION
3539. Assessments and contributions to be ratable.
3540. Assessing solvent stockholders to make up deficiencies.
3541. To what extent resident stockholders assessed where some are non-residents.
3542. Making additional assessments where prior ones prove insufficient.
3543. Form and substance of the decree.
3544. Entering a decree as to the rights of those before the court.
3545. Distribution where the plaintiff is himself a stockholder.

§ **3536. Form of Relief.** — It is a part of the ordinary method of equity procedure that an *account* taken, in order to ascertain what debts are to be paid and to whom, and what stockholders within the jurisdiction are required to contribute to their payment and to what extent.[1] If the judgment creditor is also a stockholder in the corporation, he may, according to one theory, proceed, under a well-known branch of equity jurisdiction, to have his statutory liability *set off* against his judgment;[2] and the facility with which such a remedy may be afforded in equity has been supposed to vindicate the jurisdiction of that forum; though the better view is that this right does not exist in ordinary cases after insolvency, but that he must pay up as a *debtor*, and then take his distributive share as a stockholder.[3] Equitable relief has sometimes gone so far as to award an *execution* against a particular stockholder who had paid nothing for his shares, to the extent of the whole amount due thereon.[4] This is upon the theory that where the creditor has exhausted his remedy at law, he is entitled to be *subrogated* in equity to the rights of the corporation as against any shareholder, and to have a decree awarding him an execution against such shareholder, for the full amount due by the latter to the corporation, provided so much be necessary to satisfy his judgment.[5]

[1] Holmes *v.* Sherwood, 3 McCrary (U. S.), 405; *s. c.* 16 Fed. Rep. 725; Bronson *v.* Wilmington &c. Life Ins. Co., 85 N. C. 411.

[2] Geery *v.* New York &c. Steamship Co., 12 Abb. Pr. (N. Y.) 268.

[3] *Post*, § 3786.

[4] Hickling *v.* Wilson, 104 Ill. 54.

[5] *Ibid.* Other cases proceeding substantially on this theory are Hatch *v.* Dana, 101 U. S. 205; Marsh *v.* Burroughs, 1 Wood (U. S), 468; Potter *v.* Dear, 95 Cal. 578; Baines *v.* Babcock, 95 Cal. 581; *s. c.* 29 Am. St. Rep. 158.

§ **3537. Ordering an Assessment upon the Stock.** — But the chief kind of relief, whether the corporation is being wound up by a receiver appointed by the court, or under a voluntary or statutory assignee or trustee, consists in ordering an assessment upon the shares, or against the shareholders, either to call in so much of what remains unpaid, or sometimes [1] to enforce a superadded statutory liability. Recurring to the doctrine that the assets of an insolvent corporation are a *trust fund* for its creditors,[2] and to the rule that a court of equity will never allow a trust to fail for want of a trustee, the principle at once suggests itself, that if the directors, whose duty it is to order an assessment to call in what is necessary to meet the demands of creditors, fail or refuse so to act, a court of equity will, by an order of court, make the call, so to speak, and appoint a trustee (receiver), if necessary, to collect the same, and enforce payment of the same by the proper actions against the stockholders distributively.[3] It seems to have been, at one time, the practice in England to award a

[1] *Ante*, § 3104; *post*, § 3560.

[2] *Ante*, § 2951, *et seq.*

[3] Glenn *v.* Semple, 80 Ala. 159; *s. c.* 60 Am. Rep. 92; Re Glen Iron Works, 13 Phila. (Pa.) 479; Lewis *v.* Glenn, 84 Va. 947; *s. c.* 6 S. E. Rep. 866; Glenn *v.* Williams, 60 Md. 93; Sanger *v.* Upton, 91 U. S. 56; Upton *v.* Tribilcock, 91 U. S. 45; Webster *v.* Upton, 91 U. S. 65; *s. c.* 15 Am. Law Reg. (N. S.) 638; Hall *v.* United States Ins. Co., 5 Gill (Md.), 484; Hatch *v.* Dana, 101 U. S. 205; Hawkins *v.* Glenn, 131 U. S. 319; Adler *v.* Milwaukee &c. Brick Co., 13 Wis. 57, 61; Thompson *v.* Reno Sav. Bank, 19 Nev. 242; *s. c.* 3 Am. St. Rep. 883; Ward *v.* Griswoldville Man. Co., 16 Conn. 593; Dalton &c. R. Co. *v.* McDaniel, 56 Ga. 191; Crawford *v.* Rohrer, 59 Md. 599; Marsh *v.* Burroughs, 1 Wood (U. S.), 468; Upton *v.* Hansbrough, 3 Biss. (U. S.) 417; Great Western Tel. Co. *v.* Gray, 122 Ill. 630; *s. c.* (with note) 27 Am. Law Reg. (N. S.) 160; Lamar Ins. Co. *v.* Moore, 84 Ill. 575; Patterson *v.* Lynde, 112 Ill. 196, 208. The same power was possessed by the District Courts of the United States as *courts of bankruptcy* under the late Bankruptcy Act of Congress. Upton *v.* Hansbrough, *supra;* Sanger *v.* Upton, *supra;* Myers *v.* Seeley, 1 Cent. L. J. 451. Assessments made upon the stockholders of a bankrupt corporation by the assignee in bankruptcy, directed and sanctioned by the District Court having jurisdiction of the bankrupt, were *conclusive and could not be impeached collaterally.* Michener *v.* Payson, 13 N. B. R. 49. So, the determination of the Comptroller of the Currency to appoint a *receiver of a national bank,* and his action in levying the assessment, are *conclusive* upon debtors and shareholders. Peters *v.* Foster, 56 Hun (N. Y.), 607; *s. c.* 32 N. Y. St. Rep. 174; 10 N. Y. Supp. 389.

mandamus against the directors, at the suit of a judgment creditor of the corporation, to compel them to make the necessary calls to raise funds to satisfy his execution;[1] but this remedy has been denied, for reasons which demonstrate the superior efficacy of the remedy in equity.[2] This remedy has never obtained in this country; and in some cases it has been said that it is not necessary to resort to it, since the remedy in equity is more effectual.[3] Referring to this subject, it is said by Sir Nathaniel Lindley, citing the authorities in the margin: "But as before the judicature acts, a court of equity would, so now, it is submitted, any division of the High Court will, if necessary, assist a person entitled to payment out of the funds of a company, by making a call on the shareholders, and compelling them to furnish so much of the unpaid-up capital as may be required to liquidate the demand upon them.[4] Whether they can be compelled to furnish more

[1] Reg. *v.* Ledgard, 1 Ad. & El. (N. S.) 616; Rex *v.* St. Katharine Dock Co., 4 Barn. & Ad. 360; Peg. *v.* Victoria Park Co., 1 Ad. & El. (N. S.) 288.

[2] Reg. *v.* Victoria Park Co., 1 Ad. & El. (N. S.) 288. In this case, the *mandamus* was refused, it appearing that calls sufficient to satisfy the judgment had been made but not paid, and that the company had not any longer the proper officials for making such calls. But the decision did not diminish the authority of Rex *v.* St. Katharine Dock Co., *supra*, as to the power of the court to award such a *mandamus* in a proper case. In Reg. *v.* Ledgard, 1 Ad. & El. (N. S.) 616, the court had awarded a peremptory *mandamus* to compel the mayor, aldermen, and burgesses of a municipal corporation to *make a borough rate* for the purpose of paying installments on a bond held by the relators, but discharged a rule for an attachment for disobeying it, on the ground that the *mandamus* did not show that the corporation had, or professed to have, no other means of payment; since it was not for the prosecutor to select the fund out of which payment should be made. It will be recalled that, by analogy to this use of the writ, the courts of the United States are in the constant habit of issuing this writ against the members of county courts, and other administrative boards of counties, towns, and other municipal and *quasi*-municipal corporations, to compel them to levy taxes for the payment of judgments recovered on negotiable bonds issued by such bodies and upon the coupons representing installments of interest thereon.

[3] Ward *v.* Griswoldville Man. Co., 16 Conn. 593; Dalton &c. R. Co. *v.* McDaniel, 56 Ga. 191, 195.

[4] "Law *v.* London Indisputable Pol. Co., 1 Kay & J. 223; Ex parte Durham, 4 Kay & J. 517; Talbot's case, 5 De Gex & S. 386. The 7 & 8 Vict., ch. 113, § 31, provided for making calls for the indemnity of a share-

than their respective unpaid-up installments, depends in each case upon the constitution of the company, *i. e.*, upon whether the liability of the shareholders is limited or unlimited."[1] But while a call is not necessary in order to furnish relief in equity, it is necessary, in order to entitle an attaching or judgment creditor of the corporation to proceed by *garnishment* against the stockholder,[2] for reasons hereafter given.[3]

§ 3538. Order of Assessment not Granted until General Assets Exhausted. — In the exercise of this function, a court of equity will not order an assessment against the stockholders or make a decree against them, until it is made to appear that the other assets of the corporation have been exhausted, or that such an assessment or decree is necessary for the payment of the debts.[4] The receiver, assignee in bankruptcy, or other representative of the creditors of the corporation, is, under the general principles of equity, charged with the duty and trust of collecting from the shareholders enough of what is due the corporation, in respect of their several holdings, to liquidate the debts of the company when added to its other assets, and to pay the costs of the proceeding; and he cannot collect any more; he cannot collect money from the stockholders for the purpose of paying it back to them in a final distribution.[5]

holder who had been compelled to pay a debt of the company. No act now in force contains any such provision; but his right to indemnity in such a case is clear. Whether his remedy would be by action or by a petition to wind up would depend on circumstances."

[1] Lind. Comp. Law, 5th ed., 412, 413.

[2] Bingham *v.* Rushing, 5 Ala. 403.

[3] *Post*, § 3578. As courts of equity modeled after the English court of chancery are always open and have no terms, an order authorizing an assignee for the benefit of creditors to collect unpaid subscriptions may be made by a *judge in chambers*. Citizens' &c. Sav. Bank *v.* Gillespie, 115 Pa. St. 564; *s. c.* 9 Atl. Rep. 73. Circumstances under which a court of chancery will not order a call: Re Bank of Hindustan &c., L. R. 5 Ch. 400.

[4] Crease *v.* Babcock, 10 Met. (Mass.) 525, 567; Robertson *v.* Noeninger, 20 Ill. App. 227; Bell's Appeal, 115 Pa. St. 88; *s. c.* 2 Am. St. Rep. 532.

[5] Scovill *v.* Thayer, 105 U. S. 143, 155. It has been held, under the New York Act of 1849, rendering

§ 3539. Assessments and Contributions to be Ratable. — Stockholders will be assessed and will be required to contribute *ratably* in proportion to their respective holdings of the stock of the corporation.[1] Hence, where there have been *two successive suits* to enforce the liability of stockholders, those who were not parties in the former suit should be required to contribute what they would have contributed had they been parties to it, — in other words, they must make up their deficiencies, — before another general horizontal assessment can be made.[2] Statutory schemes have already been noticed under which the *transferors* of shares remain liable to creditors for a stated period after having transferred their shares. No reason is perceived why the equities between such assigners as have responded to such liability, and their assignees, if any, remain open, and if all are parties, may not be adjusted in a final decree in equity.[3]

§ 3540. Assessing Solvent Stockholders to Make up Deficiencies. — Whether in case some of the stockholders fail to respond to such an assessment by reason of their insolvency, another assessment can be laid upon the solvent stockholders to make up the deficiency, must obviously depend upon the grounds, contractual or statutory, upon which the assessment proceeds. Where the liability is for *what remains unpaid in respect of the share subscription* of the stockholder, then it is believed that he cannot resist an assessment necessary to raise a fund to liquidate the debts of the corporation, on the ground that if other stockholders had responded the assessment would not have been necessary. In other words,

stockholders of certain *banks* individually liable for the debts of the bank, that the Supreme Court has power to order an apportionment of the debts of the corporation among the stockholders, notwithstanding there is a large amount of assets in the receiver's hands not disposed of. Re Reciprocity Bank, 29 Barb. (N. Y.) 369.

[1] *Ante*, § 1721; Perkins *v.* Sanders, 56 Miss. 733; Godfrey *v.* Terry, 97 U. S. 176, 177; Pike *v.* Bangor &c. R. Co., 68 Me. 445; Great Western Tel. Co. *v.* Burnham, 79 Wis. 47; *s. c.* 24 Am. St. Rep. 698. Compare *ante*, § 3094.

[2] Wood *v.* Wood, 40 Ill. App. 182.

[3] Railroad Co. *v.* Smith, 48 Ohio St. 219; *s. c.* 31 N. E. Rep. 743.

in such a case, the solvent members are liable to be assessed for the purpose of making up the deficiency produced by the failure of those who are insolvent.[1] Under this rule the plaintiffs in a general creditors' bill will take a decree against such stockholders as are properly made parties to the bill, or who become parties voluntarily, who are found to be solvent, for the whole amount of their debt and costs, to be apportioned among them *pro rata*, each paying such proportion of the whole debt as his stock bears to the whole amount of stock owned by the solvent stockholders who are or may be parties to the bill.[2] If a deficiency results from some of the stockholders being insolvent, there may be a *second assessment* upon those who are solvent, until the creditors are satisfied or the liability of the stockholders is exhausted.[3] This being the rule, a decree may go at once against all the solvent stockholders within the jurisdiction, who have been made parties, for the whole amount due, where it is apparent that, in any event, it will be necessary to call in all that is due from them in order to satisfy the demands of creditors.[4] But there are constitutional provisions,[5] statutes,[6] and even judicial theories, under which each stockholder is liable for his

[1] Godfrey *v.* Terry, 97 U. S. 171, 177; Munger *v.* Jacobson, 99 Ill. 349; Hodges *v.* Silver Hill Mining Co., 9 Or. 200; Perkins *v.* Sanders, 56 Miss. 733; Leucke *v.* Tredway, 45 Mo. App. 507. The proposition which has been sometimes advanced that the assessment must be ratable in the sense that those stockholders who are solvent cannot be further assessed within the limits of their liability, to *make up deficiencies caused by insolvents* to respond to their assessments,—is strangely untenable, at least in cases where the assessment is formally what is due on the share subscription; and this will appear when it is considered that, in making the assessments, the court acts merely as a substitute for the board of directors. Now, it is an unheard-of proposition that if, while the corporation is a going concern, the board of directors find it necessary to raise, by assessing its shares, a given sum of money to liquidate its debts, and it is found that, by reason of the insolvency of some of the stockholders, the assessment does not raise the required sum,—they are disabled from making another assessment to make up the deficiency. See *ante*, § 1961.

[2] Erickson *v.* Nesmith, 46 N. H. 371.

[3] Godfrey *v.* Terry, 97 U. S. 171, 177.

[4] Munger *v.* Jacobson, 99 Ill. 349.

[5] *Ante*, § 3001.

[6] *Ante*, §§ 3092, 3093.

proportionate share of the corporate debts individually and not as a guarantor or surety for his co-stockholders. In such a case the *creditors*, and not the co-shareholders, become the guarantors of the shareholders who may turn out to be insolvent, and no shareholder is liable to pay any further proportion in consequence of the inability of any other shareholder to pay his proportion.[1]

§ 3541. To What Extent Resident Stockholders Assessed Where Some are Non-residents.—If we take the premise already stated,[2] that creditors are entitled to proceed against those stockholders who are to be *found within the jurisdiction*, and are entitled to disregard the others, it should seem, as a natural conclusion, that they would be entitled to have the stockholders whom they succeed in making defendants respond, to the extent necessary to liquidate the demands of the plaintiff creditors, until the limit of their contractual or statutory liability has been exhausted.[3] But under a case presenting somewhat peculiar circumstances, Mr. Justice Story declined to charge the stockholders who were within the jurisdiction and before him, with any more than their proportionate share of the debts.[4] Under the present statutory system in Ohio, if a stockholder disposes of his stock to parties who are *insolvent or beyond the jurisdiction of the court*, but, during the time he held it, certain debts accrued against the corporation, the decree is properly made against him for his proportion of such debts.[5]

§ 3542. Making Additional Assessments, where Prior Ones Prove Insufficient. — From the premise that the solvents are assessable to make up the deficiency caused by the failure of the insolvents to respond,[6] it follows that if, by reason of

[1] Re Maria Anna &c. Coke Co., 6 Ch. Div. 447.

[2] *Ante*, § 3495.

[3] This was the theory of the Superior Court of Cincinnati, in Wehrman *v.* Reakirt, 1 Cin. Sup. (Ohio) 230.

[4] Wood *v.* Dummer, 3 Mason (U.S.), 309, 322.

[5] Mason *v.* Alexander, 44 Ohio St. 318, 338; following Brown *v.* Hitchcock, 36 Ohio St. 667. See *ante*, § 3226.

[6] *Ante*, § 3094.

the insolvency of some of the stockholders, it turns out that one assessment does not raise sufficient funds to meet the demands of the creditors, a *second assessment* may be made;[1] though, under a statute, it has been held that a second assessment is not authorized.[2] This, however, is not the sound view, unless the power of making a second assessment is restrained by statute, and then the statute is at fault. The power to make such calls is not exhausted by one effort; and even where the case is transferred to another court of competent jurisdiction, that court may make a *further call.*[3]

§ **3543. Form and Substance of the Decree.** — There is a variety of thought and practice on this subject. The view most consonant with the aims and objects of a winding-up proceeding in equity is that, before a decree can be made an *account* should be taken of the debts to be liquidated and of the amount due by each shareholder, from which, after deducting the available assets in hand, the total sum to be raised should be ascertained and apportioned among the several contributories, after which a decree should go against each shareholder for his proportion.[4] Of course, if the plaintiff fails to prove that all of those whom he impleads are in fact stockholders, this will not prevent him from proceeding to judgment against the rest.[5] Where the liability is *proportionate* to the amount of shares and to the *value* thereof which each individual may hold in the corporation, the value of the stock, in estimating the amount which each stockholder has to pay is to be taken at its *par value.*[6] So far as practicable, and within limits already stated, the burden must be ratably distributed; and therefore if some of the stockholders, without any excuse therefor, have not been served with process, it will be error to assess the whole indebtedness upon those who have

[1] Godfrey *v.* Terry, 97 U. S. 171, 177.

[2] Re Hollister Bank, 27 N. Y. 393; *s. c.* 84 Am. Dec. 292.

[3] Glenn *v.* Liggett, 135 U. S. 533.

[4] Bell's Appeal, 115 Pa. St. 88; *s. c.* 2 Am. St. Rep. 532.

[5] McHose *v.* Wheeler, 45 Pa. St. 32; Porter *v.* Kepler, 14 Ohio, 127

[6] Lane *v.* Morris, 10 Ga. 162.

been served.[1] Where one creditor sues in behalf of himself and other creditors, the decree need not be limited to the recovery of so much as is necessary to discharge the indebtedness due to the moving creditor; but it should be for the recovery of enough, if possible, to discharge all the debts of the corporation and the costs of the litigation.[2]

§ **3544. Entering a Decree as to the Rights of Those before the Court.**—Though all the shareholders are properly united in one suit in equity, yet, under a charter making the shareholders liable severally, and not jointly, when the rule of apportionment has been ascertained and the cause prepared as to any one of them, there seems no good reason why he should not be required to do justice without delaying until the others can be reached. It has, therefore, been held proper in such a case to let a decree go against a portion of the shareholders, and to continue the cause as to the others.[3] It is not perceived on what ground it can be regarded as error, for the court, without waiting for other necessary parties to be brought in, to adjudicate as to the rights of those before the court, where this can be done without prejudice to those not before it.[4] So, under a statute making the stockholders of certain corporations jointly and severally liable for certain debts of the company, the liability being, in the view of the court, that of *partners*, it has been held that the plaintiff might have a decree against such stockholders as were properly made parties to his bill, or who had become parties thereto voluntarily, who were found to be solvent, for the whole amount of their debt and costs, to be apportioned among them *pro rata*, according to the amount of stock owned by each, each paying such proportion of the whole debt as his stock bore to the whole amount of the stock owned by *solvent* stockholders who

[1] Bonewitz *v.* Van Wert County Bank, 41 Ohio St. 78.

[2] Thompson *v.* Reno Savings Bank, 19 Nev. 242; *s. c.* 3 Am. St. Rep. 883.

[3] Castleman *v.* Holmes, 4 J. J. Marsh. (Ky.) 1. But see Reynolds *v.* Feliciana Steamboat Co., 17 La. 397, 407, where this practice was held to be erroneous.

[4] Mason *v.* Alexander, 44 Ohio St. 318.

were parties to the bill. But it would not do for the plaintiffs to settle upon such as they called solvent, and omit the rest; the fact of solvency was to be settled upon proof, by the court or by a master.[1]

§ 3545. Distribution where the Plaintiff is Himself a Stockholder. — If the complainant himself be a stockholder, he should be made to contribute his share to his own debt, and to all other debts that may be established.[2] It has been held that the amount due on the shares of those stockholders who are creditors should be deducted from the amount due in respect of their stock, and that they should participate equally with other creditors in the distribution of the balance.[3] The simple meaning of this is, that those shareholders who are creditors must pay up as contributories, and may then take their dividends as shareholders, and that this may be done without the formality of making payments back and forth, or exchanging checks, but may be done in the form of adjusting the cross-accounts and striking the balance to be paid either way.[4]

[1] Erickson *v.* Nesmith, 46 N. H. 371.

[2] Perkins *v.* Sanders, 56 Miss. 733.

[3] Emmert *v.* Smith, 40 Md. 123.

[4] *Post*, § 3819.

CHAPTER LXIV.

RIGHT OF ACTION IN RECEIVER, ASSIGNEE, ETC.

SECTION
3549. Scope of this chapter.
3550. The general rule stated.
3551. General rule that right of action for unpaid subscriptions passes to receiver, assignee, trustee, etc.
3552. Right of action in assignee in bankruptcy.
3553. Right of action in assignee for creditors under State assignment law.
3554. Right of action in transferee of stock subscriptions.
3555. Right of action in purchaser of assets at receiver's sale.
3556. Right of action in indorsee of note of corporation.
3557. When the corporation may sue notwithstanding the appointment of a receiver, or an assignment in trust.
3558. When creditors may ignore the receiver and sue personally.
3559. Whether receivership of foreign corporation ousts creditors' right of action against domestic stockholders.

SECTION
3560. General rule that right of action to enforce individual liability does not pass to receiver, assignee, trustee, etc.
3561. Exceptions to this rule.
3562. Whether receiver, etc., succeeds to a higher right of action than that of the corporation.
3563. Doctrine that he does not.
3564. Further of this subject.
3565. Continued.
3566. Statute of New York under which such right of action does not pass to the receiver.
3567. Action by receiver against individual stockholders.
3568. The doctrine illustrated by the Glenn cases.
3569. When receiver or assignee may sue in equity.
3570. Common-law action brought in name of corporation to use of receiver, assignee, etc.
3571. Judgment of Federal court within the State will furnish foundation for creditors' bill.

§ **3549. Scope of This Chapter.** — It is proposed to consider in this chapter the circumstances under which the right of action against shareholders, whether to recover what is due from them to the corporation in respect of their unpaid share subscriptions, or to enforce a superadded statutory liability, vests in a receiver of the assets of a corporation appointed by a court of equity, an assignee under a statute of bank-

ruptcy, an assignee under a State insolvent law, a voluntary assignee or trustee under a deed of trust made by the corporation for its creditors, an assignee under an assignment by the corporation of a stock subscription, or other person claiming in a representative character in right of the corporation or of its creditors. In the course of the discussion there will be two principal inquiries: 1. Under what circumstances the right of action exists in such representative person, as against the creditors of a corporation, regarding them collectively or distributively. 2. Under what circumstances the right of action exists in him as against the corporation itself. Some incidental questions will necessarily be considered in the course of the discussion, and some incidental matters will be referred to, which cannot be conveniently grouped elsewhere.

§ **3550. The General Rule Stated.**—We may open this discussion with the statement of the general rule that whatever is deemed in law or equity to be *assets of the corporation* passes to its receiver, assignee in bankruptcy, or other voluntary assignee or trustee, under a proceeding taken or an assignment made for the benefit of its creditors by reason of its insolvency; and that, on the other hand, where statutes have made its stockholders liable to its creditors in such a way that the right of action vests in the creditors directly against the stockholder or stockholders, it does not pass to such receiver, assignee in bankruptcy, or other voluntary assignee for creditors; and such under some systems, though not under others, is the ordinary superadded statutory liability of the stockholders.

§ **3551. General Rule that Right of Action for Unpaid Subscriptions Passes to Receiver, Assignee, Trustee, etc.**—The general rule is, that the right possessed by the corporation while it is a going concern, upon an assessment duly made and notified under principles already discussed,[1] to pro-

[1] *Ante*, § 1701, *et seq.*

ceed against its stockholders to collect from them what remains unpaid in respect of their holdings of shares, passes, in the event of its insolvency, to whatever representative succeeds to it, whether by the appointment of a court of justice or by its voluntary selection, for the purpose of collecting its assets, paying its debts, and winding up its affairs. For the purpose of calling in such assets and enforcing the payment of the calls, he, subject to the superintendence and direction of the court which has charge of the administration, stands in the place previously occupied by the directors of the corporation.[1] Where the right of action has thus passed to one who stands as the representative of all the parties in interest, it necessarily follows that it has passed to the exclusion of a separate right of action on the part of any single party in interest, and that a single creditor cannot thereafter prosecute a separate action to charge the stockholders; and further, that such an action on the part of a single creditor will, in conformity with what has already been stated,[2] be enjoined.[3]

§ 3552. Right of Action in Assignee in Bankruptcy. — Upon like grounds, an assignee in bankruptcy, under the late Federal Bankruptcy Law, might sue to recover the amounts due by stockholders on account of their stock subscriptions.[4]

[1] Hightower *v.* Thornton, 8 Ga. 486, 504; *s. c.* 52 Am. Dec. 412; Rankine *v.* Elliott, 16 N. Y. 377; Sagory *v.* Dubois, 3 Sandf. Ch. (N. Y.) 466; Lewis *v.* Robertson, 13 Smedes & M. (Miss.) 558; Showalter *v.* Laredo Improvement Co., 83 Tex. 162; *s. c.* 18 S. W. Rep. 491; Minnesota Thresher Man. Co. *v.* Langdon, 44 Minn. 37; *s. c.* 46 N. W. Rep. 310; Vanderwerker *v.* Glenn, 85 Va. 9; *s. c.* 6 S. E. Rep. 806; 27 Cent. L. J. 386; 4 Rail & Corp. L. J. 84; 24 Am. & Eng. Corp. Cas. 526; Howard *v.* Glenn, 85 Ga. 238; *s. c.* 11 S. E. Rep. 610; 21 Am. St. Rep. 156; Merchants' Nat. Bank *v.* Northwestern Man. &c. Co., 48 Minn. 361; *s. c.* 51 N. W. Rep. 119; Van Wagenen *v.* Clark, 22 Hun (N. Y.), 497; Means's Appeal, 85 Pa. St. 75.

[2] *Ante*, § 3520; Minnesota Thresher Man. Co. *v.* Langdon, 44 Minn. 37; *s. c.* 46 N. W. Rep. 310, — where it is said: "It cannot be that a right of creditors, each in his own behalf, to maintain actions under section 139 [of the Minnesota statute] can exist at the same time." So held in Merchants' Nat. Bank *v.* Northwestern &c. Co., 48 Minn. 361; *s. c.* 51 N. W. Rep. 119.

[3] See *post*, ch. 187.

[4] Sawyer *v.* Hoag, 17 Wall. (U. S.) 610; Upton *v.* Tribilcock, 91 U. S. 45; Webster *v.* Upton, 91 U. S. 65; Scovill *v.* Thayer, 105 U. S. 143; Payson *v.*

Otherwise as to individual liability of stockholders or directors under the provisions of statutes.[1] The court of bankruptcy might make the assessments,[2] and it was discretionary with that court whether it did so with or without notice to the stockholder. At all events, in a suit by the assignee the propriety of the court's action in this regard could not be inquired into.[3]

§ **3553. Right of Action in Assignee for Creditors under State Assignment Law.**—The *unpaid balances* owing by the shareholders to the corporation in respect of their shares are, as already seen, *equitable assets* of the corporation,[4] and are part of its general assets which constitute a *trust fund* for its creditors.[5] They are in the nature of choses in action of the corporation, and are *property* belonging to it; and hence, although not presently due and payable, because not yet called for by the directors, they are property in such a sense that they will pass to an assignee of the corporation under a general deed made by it, in pursuance of a State statute, assigning all its property to a trustee to be administered for the benefit of its creditors;[6] and thereafter a single creditor cannot proceed by action at law or motion for execution against a stockholder.[7] This conclusion does not rest upon any express statutory provision, but, independently of any statute, and upon the general theories of equity, any voluntary assignment not unlawfully made by the corporation, of all its property, to be administered for the benefit of its creditors, will have this effect.[8] Such an assignee of a corporation who has not resigned

Stoever, 2 Dill. (U. S.) 427; Upton *v.* Hansbrough, 3 Biss. (U. S.) 417; *s. c.* 5 Chi. Leg. N. 242.

[1] *Post*, § 3560.

[2] Upton *v.* Hansbrough, 3 Biss. (U. S.) 417; Myers *v.* Seeley, 1 Cent. L. J. 451; Sanger *v.* Upton, 91 U. S. 56, 60.

[3] Upton *v.* Hansbrough, 3 Biss. (U. S.) 417; Payson *v.* Stoever, 2 Dill. (U. S.) 427; Webster *v.* Upton, 91 U. S. 65.

[4] *Ante*, § 2951, *et seq.*

[5] *Ante*, § 2952.

[6] Lionberger *v.* Broadway Sav. Bank, 10 Mo. App. 499; Shockley *v.* Fisher, 75 Mo. 498; Eppright *v.* Nickerson, 78 Mo. 482; Boeppler *v.* Menown, 17 Mo. App. 447, 450.

[7] Franklin *v.* Menown, 10 Mo. App. 570; Menown *v.* Crawford, 10 Mo. App. 574.

[8] Reasoning in the cases before cited, and in Showalter *v.* Laredo Imp. Co., 83 Tex. 162; *s. c.* 18 S. W. Rep. 491.

his trust, where there are creditors for whom he must provide, is not prevented from bringing suit to enforce the liability of a stockholder by the fact that he has suffered the stockholders to *resume business* with the machinery assigned to him, taking a bond for its protection.[1]

§ 3554. Right of Action in Transferee of Stock Subscriptions. — What is stated in the preceding section necessarily follows, as a general conclusion of law, when it is stated that a corporation whose charter gives it the general power to make all contracts which its convenience and interest may require, has power, in carrying out the enterprise authorized by its charter, to assign its stock subscriptions, there being nothing in the charter imposing any restriction in that respect; and that the assignee may sue the stockholder and recover from him the amount which he has subscribed, the same as the company might have done, — the company having made the requisite calls.[2] But this principle does not extend to a case where one corporation undertakes to buy, as a mere speculation, the stock subscriptions of another corporation, and where such a purchase is not within the scope of its granted powers; and accordingly it was held that one railroad corporation could not, from the mere circumstance of having purchased the roadbed of another with intent to complete the road, acquire the power to purchase the stock subscriptions of the vendor company and enforce them by actions against the stockholders.[3] The assignee of a demand against a corporation takes it with all its advantages and incidents, just as the purchaser of a note secured by a mortgage succeeds to the rights of the mortgagee: he therefore succeeds to the benefit of any statutory provision by which the stockholders are made liable to answer for the particular corporate debt.[4]

[1] Cartwright *v.* Dickinson, 88 Tenn. 476; *s. c.* 17 Am. St. Rep. 910; 7 L. R. A. 809; 12 S. W. Rep. 1030.

[2] Downie *v.* Hoover, 12 Wis. 174; *s. c.* 78 Am. Dec. 730; Downie *v.* White, 12 Wis. 176; *s. c.* 78 Am. Dec. 731; *ante*, § 1818.

[3] West End &c. R. Co. *v.* Dameron, 4 Mo. App. 414.

[4] Came *v.* Brigham, 39 Me. 35.

§ 3555. Right of Action in Purchaser of Assets at Receiver's Sale. — He also takes it subject to its burdens and disadvantages; and as such a chose in action is not a negotiable instrument, he does not get any higher right or any greater remedy against the stockholder than the corporation had to transfer; and where the transfer was made by the *receiver* of the corporation, in a general sale of its uncollected assets, it was held that no right of action against individual stockholders passed to the assignee, because the receiver, under the governing statute, had no such right of action;[1] though it is submitted that the proper question was, whether the *corporation* had such a right of action, since the receiver conveyed nothing in his own right, but only conveyed the credits of the corporation and in right of the corporation. Moreover, even where the receiver possesses the right of action, an order of court directing him to sell the right of action may not be large enough to include it. It was so held of an order of court directing the sale by the receiver of "all the assets, property, and business" of the insolvent corporation. But the court also proceeded upon other grounds, in coming to the conclusion that such a sale did not pass the right of the receiver to maintain an action against the stockholders to recover from them *dividends declared and paid out of the capital* of the company. The court rested its conclusion chiefly on the ground that such a sale would merely be the sale of undetermined and speculative rights of action; that it would result in multiplying vexatious litigation, and in sacrificing the rights of creditors, and would therefore be against public policy.[2] But the point is somewhat overreasoned; and while one can readily concur in so much of the reasoning as above stated, and also in the result, he may not be able to concur in the proposition that the corporation itself would have had no power to impeach this act of its directors, committed in breach of their trust, in declaring and

[1] Van Wagenen *v.* Clark, 22 Hun (N. Y.), 497.

[2] Minnesota Thresher Man. Co. *v.* Langdon, 44 Minn. 37; *s. c.* 46 N. W. Rep. 310.

paying dividends out of the capital stock. The reasoning of the court is substantially this: 1. That a corporation has no right of action to recover dividends declared and paid out of its capital stock; 2. That a receiver of its assets has such a right of action; 3. That the receiver cannot transfer this right of action, nor can it be transferred by the court, under an order of sale by the receiver of the assets and rights in action of the corporation. Notwithstanding what we have said in a former title,[1] upon a further consideration of this question, and especially in view of what is said hereafter,[2] we submit that the corporation has the power to maintain an action against its stockholders to recover *dividends* unlawfully declared and paid. Constitutional provisions and statutes exist in nearly every State in the Union[3] prohibiting the payment of such dividends. Their payment is therefore a *breach of trust* on the part of the directors, by which the assets of the company are distributed and squandered; and to hold that a corporation has no right of action to recover such dividends is simply to hold that it has no right of action to recover its property which its trustees have distributed in breach of their trust, and in violation of law. It is believed, then, to be the true view, and for reasons more fully gone into elsewhere,[4] that the receiver of a corporation *derives from the company* his right of action to recover dividends paid out of its capital. At the same time, to allow such a right of action to be sold would simply be the judicial sale of litigation, — or rather of a mass of litigious possibilities sold in a lump, and such a sale would multiply the evils of champertous contracts tenfold.

§ 3556. Right of Action in Indorsee of Note of Corporation. The indorsee of a note of a corporation is entitled to sue a stockholder, to collect the note from him, under the following statute: "The stockholders of said corporation shall be jointly and severally personally liable for the payment of all debts or demands contracted by the said corporation or their

[1] *Ante*, § 2135.
[2] *Post*, § 4292.
[3] *Post*, § 4288, *et seq.*
[4] *Post*, ch. 161.

authorized agent or agents; and any person having any demand against the said corporation may sue any stockholder, director, or directors, in any court having cognizance thereof, and recover the same, with costs."[1]

§ 3557. When the Corporation may Sue Notwithstanding the Appointment of a Receiver, or an Assignment in Trust. After the corporation has made a deed of assignment in trust for the benefit of its creditors, it cannot, of course, maintain an action in its own right upon any choses in action included in the deed of assignment, though, as hereafter seen, the assignee must sue in the name of the corporation to his own use, where the common-law system of pleading still prevails.[2] It has been well said that the corporation, notwithstanding it may have ceased the prosecution of the objects for which it was organized, can still proceed in the collection of debts, the enforcement of liabilities, and the application of its assets to the payment of its creditors, all corporate powers essential to those ends remaining unimpaired.[3] And we have also seen that, notwithstanding a cesser of business such as for some purposes operates as a *de facto* dissolution,[4] the corporation is still capable of representing its stockholders in its character of defendant in a creditor's suit in equity.[5] The appointment of a receiver will, it may well be assumed, disable the corporation from thereafter commencing any action to collect any debt or enforce an assessment against its stockholders, unless the order appointing the receiver is so framed as to permit it to bring such actions; but it will not, it may be assumed, operate to suspend the prosecution of actions already commenced by it, unless the receiver is appointed in pursuance of a statute which so declares, or unless the order appointing the receiver is accompanied with an order enjoining the further prosecution of such actions.[6] We have had occasion

[1] Moss *v.* Averell, 10 N. Y. 449; Freeland *v.* McCullough, 1 Denio (N. Y.), 414; *s. c.* 43 Am. Dec. 685.

[2] *Post*, § 3570.

[3] Hawkins *v.* Glenn, 131 U. S. 319, 331.

[4] *Ante*, § 3499.

[5] Hawkins *v.* Glenn, *supra;* Hamilton *v.* Glenn, 85 Va. 901; and the other Glenn cases.

[6] See *post*, ch. 159.

to refer to a recent case in the English Chancery Division, where, notwithstanding a general winding-up proceeding had been commenced under the Companies Act, 1862, and what is termed under that statute a "balance order" had been made against a particular shareholder, which is understood to be tantamount to such a judicial assessment as was made by the Virginia courts successively in the Glenn cases, — an action could be prosecuted against a delinquent shareholder in the name of the corporation, although not in form to the use of the official liquidator.[1] A recent holding in Alabama is to the effect that a provision of the code of that State,[2] declaring the stockholders of a private corporation to be individually liable to its creditors for the unpaid stock owned by them, was enacted for the purpose of harmonizing the statutes with the new constitution, and is applicable alike to solvent and insolvent corporations, and does not take away the right of the governing body of the corporation to enforce such liability of the stockholder; nor does it give to the creditors alone the right of action therefor.[3]

§ **3558. When Creditors may Ignore the Receiver and Sue Personally.** — Where a receiver, appointed to wind up the affairs of a bank, stated in his answer that he did not deem it his duty to sue the stockholders on behalf of the creditors, it was held that the creditors were warranted in commencing their suit against the stockholders *without first requesting the receiver to sue* them.[4]

§ **3559. Whether Receivership of Foreign Corporation Ousts Creditors' Right of Action against Domestic Stockholders.** — The answer to this inquiry must depend upon principles and theories considered in a former chapter.[5] In Massachusetts,[6] West Virginia,[7] Illinois,[8] and perhaps in other

[1] Westmoreland Green &c. Co. *v.* Fielden [1891], 3 Ch. 15, C. A.

[2] Ala. Code, § 2023.

[3] Chamberlain *v.* Bromberg, 83 Ala. 576; *s. c.* 3 South. Rep. 434.

[4] Atwood *v.* Rhode Island Agricultural Bank, 1 R. I. 376.

[5] *Ante*, § 3046, *et seq.*

[6] *Ante*, § 3056, *et seq.*

[7] *Ante*, § 3057.

[8] *Ante*, § 3460.

jurisdictions, where the theory has obtained that the working out of the equities of the creditors and shareholders of an insolvent requires "local administration," undoubtedly the fact that such "local administration," has been commenced in the forum of the domicile of the corporation, by the appointment of a receiver, will cut off any right of action which an individual creditor might otherwise have possessed against a domestic stockholder; though it will not escape attention that the doctrine of the courts referred to probably would not admit of such right of action, even though such "local administration" had not been commenced. But in New York, where this doctrine does not seem to have obtained, it has been held that the fact that a receiver *may* have been appointed of a dissolved foreign corporation, will not prevent a domestic creditor from maintaining an action against a stockholder in this State in wrongful possession of its assets.[1]

§ 3560. General Rule that Right of Action to Enforce Individual Liability does not Pass to Receiver, Assignee, etc. It may be stated, as a general rule, that statutes making stockholders *individually liable* to creditors, independently of what they owe the corporation on account of their stock, create a right flowing directly from the stockholders to creditors. The sums thus secured to creditors form no part of the assets of the company, but are a supplemental or superadded security for the benefit of creditors.[2] An attempted assignment of this security is therefore inoperative.[3] No action to enforce such liability can be brought by a receiver or assignee of the corporation; such an action must be brought by one or more of the creditors.[4]

§ 3561. Exceptions to This Rule.—This rule has, however, in some cases, been changed by statute, so as to vest in

[1] Dayton *v.* Borst, 31 N. Y. 435.

[2] Hanson *v.* Donkersley, 37 Mich. 184.

[3] Wright *v.* McCormack, 17 Ohio St. 86; Umsted *v.* Buskirk, 17 Ohio St. 113; Dutcher *v.* Marine Nat. Bank, 12 Blatchf. (U. S.) 435.

[4] Lane *v.* Morris, 8 Ga. 468; Dutcher *v.* Marine Nat. Bank, 12 Blatchf. (U. S.) 435; Bristol *v.* Sanford, 12 Blatchf. (U. S.) 341; Jacobson *v.* Allen, 20 Blatchf. (U. S.) 525.

trustees the right to enforce, on behalf of creditors, such a statutory liability;[1] and it has been held that such a statute, in its application to existing contracts, is not unconstitutional.[2] It does not apply to the case of the statutory liability of shareholders in *national banks*, arising under the twelfth section of the National Banking Act.[3] The receiver appointed by the Comptroller of the Currency is the proper party to bring such a suit, whether at law or in equity, and creditors are not proper parties to such a bill.[4]

§ 3562. Whether Receiver, etc., Succeeds to a Higher Right of Action than That of the Corporation. — This question has been variously answered by the courts, and their answers have been more or less influenced by the provisions of statutes. A strictly logical though narrow view of the question is that, unless the powers of the receiver, or other representative of the creditors, have been enlarged by statute, he succeeds to no right of action which the corporation might not have possessed, since his office is merely to gather in the assets of the corporation, and to that end to enforce whatever rights of action it may have had.[5] But it is perceived that this rule will disable the receiver, or other representative of the creditors, from impeaching transactions of the corporation entered into in fraud of their rights. His powers have been therefore necessarily and beneficially enlarged, in some cases by judicial theory, and in other cases by statute.[6] Thus, it has been held,

[1] Walker *v.* Crain, 17 Barb. (N. Y.) 119; Story *v.* Furman, 25 N. Y. 214, 231.

[2] Walker *v.* Crain, 17 Barb. (N. Y.) 119; Story *v.* Furman, 25 N. Y. 214, 231. A partnership firm can maintain a bill against directors for declaring a dividend prohibited by statute, although one member of the firm plaintiff was also a director, and is sued as defendant. Archer *v.* Rose, 3 Brewst. (Pa.) 264.

[3] 13 U. S. Stat. at Large, 99; Rev. Stat. U. S., § 5151.

[4] Kennedy *v.* Gibson, 8 Wall. (U. S.) 498.

[5] See the following cases, as sustaining this view: Coope *v.* Bolles, 42 Barb. (N. Y.) 87; Hyde *v.* Lynde, 4 N. Y. 387; and other cases cited in next section. See *post*, ch. 161.

[6] See 2 Mor.Priv.Corp., § 867; High on Receivers, § 315; Curtiss *v.* Leavitt, 15 N. Y. 9, 44; Sawyer *v.* Hoag, 17 Wall. (U. S.) 610, 619; Alexander *v.* Relfe, 74 Mo. 495; Sagory *v.* Dubois, 3 Sandf. Ch. (N. Y.) 466.

on general principles of equity, that where an indebtedness of a stockholder to the corporation for stock has been fraudulently discharged, the receiver of the corporation is the proper person to sue for its recovery.[1] So, under the *Federal Bankruptcy Act* of 1869, the powers of the assignee were distinctly enlarged in this respect. This officer was the representative of the creditors, as well as of the bankrupt. He was appointed by the creditors. The statute was full of authority to him to sue and recover property, rights, and credits, where the bankrupt could not have sustained the action, and to set aside as void, transactions by which the bankrupt himself would have been bound.[2] So, it has been held that the receiver of an insolvent corporation can enforce the payment of what is due by the shareholders in respect of their share subscriptions, although a vote has been passed by the directors that no further calls shall be made, and further, that the amount of an unauthorized dividend cannot be deducted.[3] And so he may maintain actions against shareholders to recover *dividends* paid to them out of the capital of the company, although it is supposed (erroneously, the writer thinks) that the corporation could not.[4]

§ **3563. Doctrine that He does not.** — On the other hand, it has been held that the *receiver* of an insolvent *national bank* cannot enforce against subscribers to its stock any right which the association itself could not have asserted.[5] So, in Illinois it has been held that the powers of a receiver of an insurance company, appointed under the provisions of the statute of that State enacted in 1874, relating to the dissolution of insurance companies, are no greater than a voluntary assignee for creditors, and that he can proceed only in right of the corporation, and enforce by action only such rights as the

[1] Nathan *v.* Whitlock, 9 Paige (N. Y.), 152, 153.

[2] Sawyer *v.* Hoag, 17 Wall. (U. S.) 610.

[3] Sagory *v.* Dubois, 3 Sandf. Ch. (N. Y.) 466.

[4] Minnesota Thresher Man. Co. *v.* Langdon, 44 Minn. 37; *s. c.* 46 N. W. Rep. 310.

[5] Winters *v.* Armstrong, 37 Fed. Rep. 508, 521.

corporation might have enforced; and accordingly, that he has no power to impeach a transaction between the corporation and its stockholders by which they *surrendered* their shares to the company.[1] So, in a case in Maine it was held that the trustee of a corporation, under a winding-up statute, which gave them the power to take charge of the estate and effects of the corporation, to collect its debts and prosecute and defend actions, etc., had no right of action which the corporation could not have had.[2] This is in accordance with the theory of the English courts, where the official liquidator appointed to wind up a company under the Companies Act, 1862, of that country, can proceed only in right of the company, and enforce no right of action which the company could not have enforced.[3] In several of these cases it is said in substance that if creditors have higher rights of action than the corporation would have had, they must assert such rights themselves in the proper proceeding.[4]

§ **3564. Further of This Subject.**—Some of the foregoing decisions illustrate in a conspicuous degree the extent to which judges tire out and halt on the road to justice. The premise that a receiver, assignee, or other representative of the creditors appointed to administer the assets of an insolvent corporation, cannot impeach transactions which the corporation itself could not impeach, does not lead to some of the results which the courts have reached in cases cited in the preceding section. They overlook the obvious principle that the corporation itself would not be estopped from impeaching transactions by its unfaithful directors, by which it is made to release its shareholders from the payment of their share sub-

[1] Republic Life Ins. Co. *v.* Swigert, 135 Ill. 150; *s. c.* 25 N. E. Rep. 680; 9 Rail. & Corp. L. J. 22.

[2] Piscataqua Fire &c. Ins. Co. *v.* Hill, 60 Me. 178.

[3] Waterhouse *v.* Jamieson, L. R. 2 H. L. (Sc.) 29; Re Duckworth, L. R. 2 Ch. 577; Litchfield's case, L. R. 1 Eq. 231; Ex parte Currie, 32 L. J. (Ch.) 57; *s. c.* 3 De Gex, J. & S. 367; 7 L. T. (N. S.) 486; Carling's case, 1 Ch. Div. 115; Burkinshaw *v.* Nicolls, 3 App. Cas. 1004; *s. c.* 26 Week. Rep. 821.

[4] *Ibid.;* Republic Life Ins. Co. *v.* Swigert, *supra.*

scriptions. They overlook the proposition that, although a trustee who makes a contract in breach of his trust may be estopped from repudiating it and reclaiming the trust funds thereby squandered in fraud of the rights of the beneficiaries in the trust, except where the rights of innocent purchasers come into play, yet his successor in the trust is not, at least in equity, so estopped.[1] They overlook the further fact that the most essential part of the doctrine of *ultra vires* is predicated upon the right of a corporation to repudiate breaches of trust committed by its unfaithful directors or agents, and to retain what it would thereby lose, or recover what it has thereby lost, where superior equities do not supervene. On parallel lines of reasoning, where the trustees of a corporation deal with its assets, which constitute a trust fund for its creditors, in breach of the trust under which they are bound to deal with that fund, the corporation itself may repudiate their acts, and reclaim such portion of the fund as they have squandered, from every person not an innocent purchaser for value. We have already seen that a corporation in general has no legal capacity to release the subscribers to its shares from the obligation of their subscriptions, and that such releases are *ultra vires* in such a sense that they do not estop the corporation.[2] Upon this ground the receiver, assignee, or other representative of creditors, in charge of the assets of an insolvent corporation, ought to be allowed to impeach such contrivances, even where the theory obtains that he has no higher right of action than the corporation itself would have had. The true distinction on this point is brought out by Mr. Circuit Judge Jackson,[3] in a case where he recognized and proceeded upon the principle that a receiver has no higher right of action than the corporation would have had, but nevertheless qualified it

[1] The Supreme Court of the United States has recently decided, in a case of great importance, that where the Legislature of a State in breach of the public trust with which it is clothed, grants one of its public *harbors* to a private corporation, a subsequent Legislature may repeal the grant. Illinois Central R. Co. *v.* Illinois, 146 U. S. 387.

[2] *Ante*, § 1514.

[3] Now a judge of the Supreme Court of the United States.

as follows: "When the corporation is insolvent, the rights of creditors in respect to the corporate assets become most prominent, and a receiver appointed to administer or collect such assets is regarded as more directly the representative of creditors. In a certain class of cases a receiver may assert rights which the corporation could not. Thus, he may disaffirm illegal and fraudulent transfers of corporate property, and may recover its funds and securities which have been misapplied. The governing officers of a corporation cannot, for example, release a stockholder, or a subscriber for its stock, from his obligation to pay, to the prejudice of creditors. They cannot return to stockholders the capital stock of the corporation, which constitutes a trust fund for the benefit of creditors, to the injury of such creditors. They can make no fraudulent disposition of the corporate property for their private benefit, or for the benefit of the stockholders, leaving creditors unprovided for. These, and like transactions involving the misapplication or fraudulent disposition of corporate property, a receiver may disaffirm, and recover such assets for the benefit of creditors, when the corporation might not be in position to do so."[1] The learned judge cited the cases in the margin as illustrative of the principle that the receiver may assert rights which the corporation or its management could not enforce.[2] It was held that the receiver appointed by the Comptroller of the Currency to wind up the affairs of the bank after its insolvency, could not charge the subscribers as shareholders, because the corporation could not have done it.[3] But

[1] Winters *v.* Armstrong, 37 Fed. Rep. 508, 521.

[2] Wood *v.* Dummer, 3 Mason (U. S.), 308; Curran *v.* State, 15 How. (U. S.) 304; Burke *v.* Smith, 16 Wall. (U. S.) 390; New Albany *v.* Burke, 11 Wall. (U. S.) 96; Sawyer *v.* Hoag, 17 Wall. (U. S.) 610, 619. But he distinguished the case before him on the ground that the stockholders against whom the receiver was proceeding were not the recipients of corporate property which had been fraudulently or wrongfully divested, misapplied, or disposed of to the prejudice of creditors. There had been an attempted increase of the capital stock of a national bank without complying with the provisions of the governing statute, and the subscribers to the increased stock were ignorant of this want of compliance.

[3] Winters *v.* Armstrong, *supra.*

it is submitted that the true distinction is,—or at least ought to be,—that in such cases as those last cited the corporation itself would not be estopped, while a going concern, from impeaching the transaction.

§ **3565. Continued.**—A case in New York also furnishes a good illustration of the same principle. The shareholder had sold his shares and transferred his certificate to his vendee, by delivering it to him with the usual assignment in blank indorsed upon it. The shares were not formally transferred to the vendee on the books of the corporation, but an indorsement was made on its dividend book that the dividends were to be paid to the vendee, and they were so paid for four years thereafter. There was no declaration in the charter or by-laws that the transfer could only be effected by an entry on the books of the corporation. Subsequently, the corporation became insolvent, and the receiver in charge of its assets brought an action against the vendor of these shares to recover from him an unpaid balance due in respect of them. It was held that he could not recover; that the vendee took a perfect title; that the corporation, having recognized him as the owner of the shares, could not have contested his title; and that the receiver occupied in this respect no better right than the corporation.[1] But this leaves ample room for the distinction that where the directors of a corporation have given away its assets in breach of their trust, by releasing subscribers to its shares, a receiver, after it becomes insolvent, may impeach the transaction; it therefore does not conflict with the cases in New York which so hold, cited in a preceding section.[2] The cases which have taken the wrong road on this question seem to proceed upon the analogy of the rule that a conveyance in fraud of the creditors of the vendor is good as between the parties to the deed. But this, it is submitted, is not the correct analogy. The correct analogy is, that a corporation is never estopped, except in favor of innocent purchasers, or of other persons possessing superior equities, from reclaiming

[1] Cutting *v.* Damerel, 88 N. Y. 410.

[2] *Ante*, § 3562, note 2.

portions of the trust fund which their unfaithful directors have squandered in breach of their trust, and that a receiver of its assets, although proceeding merely in its right, cannot therefore be so estopped.

§ 3566. Statute of New York under Which Such Right of Action does not Pass to the Receiver.—There are particular statutory systems under which even the right to enforce the payment of unpaid subscriptions may not pass to a receiver or other representative of the creditors of the corporation. It is so held, as the proper construction of the *New York statute of 1848 relating to manufacturing corporations.* Here the receiver cannot maintain an action against a stockholder to recover a general assessment, based on the company's entire indebtedness,[1] but the right of action is only in the separate creditors.[2] But the rule is different in case of proceedings under the New York Act of 1852, in respect of corporations formed under the Act of 1811, with reference to which the Act of 1852 was framed.[3] But the right of action given by the Act of 1848 is conferred only *upon creditors*, and then only on those coming within the prescribed conditions.[4] These decisions of the New York Court of Appeals do not show, by any satisfactory course of reasoning, what ground there is for concluding that the statute was intended to displace the general powers of a court of equity, through its receiver, to assess the shareholders in respect of their unpaid subscriptions, and to enforce such assessments through actions prosecuted by the receiver against the shareholders. We have already seen,[5] that the liability of a shareholder to pay what is unpaid in respect of his shares is *an obligation founded in contract* and not depending upon statutes, and that the sequestering of the unpaid subscriptions of the shareholders for the benefit of the creditors of the corporation, when it becomes insolvent, is merely a means devised by courts of equity to compel men to pay their honest debts. This jurisdiction of equity, so just and necessary, ought not to be regarded as ousted

[1] Cuykendall *v.* Corning, 88 N. Y. 129.

[2] Tucker *v.* Gilman, 45 Hun (N. Y.), 193.

[3] Cuykendall *v.* Corning, 88 N. Y. 129, 140; explaining in this way Walker *v.* Crain, 17 Barb. (N. Y.) 119, 128; and Story *v.* Furman, 25 N. Y. 214; and overruling, it seems, Hurd *v.* Tallman, 60 Barb. (N. Y.) 272.

[4] Farnsworth *v.* Wood, 91 N. Y. 308.

[5] *Ante*, § 3047.

by any statute relating to the subject, unless the statute says so in plain terms or by an unavoidable implication.[1]

§ 3567. Action by Receiver against Individual Stockholders.—Where all the stockholders within the jurisdiction are made parties to the creditors' bill, which has resulted in the appointment of a receiver, separate actions by the receiver against the individual stockholders are not necessary; since, as already seen,[2] after the appropriate amount due from each is ascertained, a decree goes that he pay the same to the receiver.[3] But where the receiver proceeds to collect what is due from stockholders outside of the jurisdiction, he must, it seems, proceed by an action at law, just as the corporation

[1] The confusion in the decisions of the courts of New York upon this question, largely the result of different statutory schemes, is further illustrated by the leading case of Mann *v.* Pentz, 3 N. Y. 415, where it was held that the receiver of a *railroad* corporation could not maintain separate suits in equity against stockholders to recover the unpaid balances upon their subscriptions, but that the bill should be filed by a *creditor*, in behalf of all the creditors, against the corporation and all the shareholders who have not paid up their subscriptions, so that an account may be taken of the debts and assets of the corporation, of the amount of capital not paid in, and of the sum due from each shareholder. If there is any sense in this decision at all, it is founded on the idea that there is no such right of action in the receiver until there is a previous general accounting and an assessment of the percentage which ought to be collected from each shareholder. This decision is often quoted in favor of the proposition that there is no right of action against the shareholders distributively by the receiver; and it was quoted to this point in subsequent cases arising under the same section of the same statute. Tucker *v.* Gilman, 45 Hun (N. Y.), 193. On the other hand, it was held in Van Wagenen *v.* Clark, 22 Hun (N. Y.), 497, that a receiver of an insolvent *railroad* company *could*, under chapter 403 of the Act of 1860, maintain separate actions against any of the stockholders, to recover any sum remaining due upon his shares, and that he was not bound to bring one action and make all the creditors and stockholders parties. The decision in Mann *v.* Pentz, *supra*, was rendered by the Court of Appeals, the highest judicial court in that state, and the decisions quoted from Hun were the decisions of the Supreme Court, which is an intermediate court. Mann *v.* Pentz is probably authoritative in New York in regard to *railroad* corporations; while, in regard to *manufacturing* corporations, we must rest on Cuykendall *v.* Corning, 88 N. Y. 129; and Farnsworth *v.* Wood, 91 N. Y. 308.

[2] *Ante*, § 3543.

[3] Examine on this point the reasoning in Mann *v.* Pentz, 3 N. Y. 415.

would proceed in an action for calls.[1] In such a case, we have seen[2] that it is no defense on the part of the stockholder that he has not had notice of the action in which the receiver has been appointed. It is further obvious that, in such an action against a shareholder, an exemplification of the record of the proceedings in which the receiver has been appointed is admissible in evidence, for the purpose of showing his authority to sue; and this though the shareholder was not a party to that proceeding, the record not being offered as evidence of an adjudication of *his* rights.[3] In Virginia a trustee appointed by the court in a proceeding to wind up an insolvent corporation, who has been authorized to collect an assessment which the court had ordered, may sue therefor *in his own name*, under a provision of the code of that State which empowers an assignee of "any bond, note, or writing not negotiable," to bring an action thereon in his own name.[4] Where an assignment has been made by a corporation of its *assets for the benefit of its creditors*, and its unpaid stock subscriptions have been expressly included in the assignment,—it has been held that a court of equity may, on the application of a creditor, order an assessment, and that the trustee may bring actions against the respective shareholders to recover the same.[5] And the better opinion is, that a general assignment for the benefit of creditors carries with it, by implication, the unpaid stock subscriptions, as choses in action of the corporation. And the assignee may bring such action in his own name, especially where the deed of trust has conveyed to him the right to receive the unpaid subscriptions.[6] No sound reason is perceived why the receiver appointed by

[1] Howard *v.* Glenn, 85 Ga. 238; *s. c.* 21 Am. St. Rep. 156; 11 S. E. Rep. 610; and other Glenn cases, *post*, § 3570, note.

[2] *Ante*, § 3497.

[3] Hall *v.* United States Ins. Co., 5 Gill (Md.), 484.

[4] Lewis *v.* Glenn, 84 Va. 947.

[5] Vanderwerken *v.* Glenn, 85 Va. 9; *s. c.* 6 S. E. Rep. 806.

[6] *Ante*, § 3551. By analogy to this, an order appointing a receiver to take charge of the "whole property" of an insolvent corporation will empower him to sue for and recover unpaid subscriptions to the stock of the corporation. Showalter *v.* Laredo Imp. Co., 83 Tex. 162; *s. c.* 18 S. W. Rep. 491.

the court in such a proceeding cannot maintain actions in the proper forum against separate shareholders, provided the amount to be collected from each is first ascertained and assessed by an order of court. But, as already seen,[1] the law of New York denies such a right of action to a receiver of the assets of a domestic manufacturing corporation,[2] while conceding it, by comity, to the receiver of a foreign corporation.[3]

§ 3568. The Doctrine Illustrated by the Glenn Cases. — The doctrine of the preceding section is well illustrated by the decision of the Court of Appeals of Virginia in one of the many separate actions known as the Glenn cases.[4] In this case an incorporated express company, having stockholders in many different States of the Union, became insolvent, and made a deed of assignment to trustees of all its estate, property, rights, and credits, of every kind, and all its other effects, including moneys payable to it, whether on calls or assessments, on stock or on notes, bills, accounts, etc., for the benefit of its creditors. The corporation, directors, stockholders, and the trustees to whom the assignment had been made, then abandoned the enterprise which the corporation had been conducting, and took no steps to pay its debts. A creditor, having obtained a judgment at law against the corporation, thereafter filed a creditor's bill against the company, making the president, the directors, and the trustees in this deed of trust, parties defendant thereto. There were no assets, except balances due from stockholders on their shares to the extent of eighty per cent of the par value thereof. The court removed the trustees and appointed another to take their place, namely, Mr. Glenn, and charged him with all the duties of the trustees thus removed. The court also ordered that a call of thirty per cent be made on each share, and authorized the substituted trustee to collect the same by suit or otherwise. This action was then brought by the substituted trustee against the defendant, to collect the thirty per cent due from him under this call. It was held that the substituted trustee, and not the corporation, was the proper party to bring the action, the legal title having been assigned by the corporation. The court reasoned

[1] *Ante*, § 3566.

[2] Mann *v.* Pentz, 3 N. Y. 415.

[3] Dayton *v.* Borst, 31 N. Y. 435. Compare Kennedy *v.* Gibson, 8 Wall. (U. S.) 498.

[4] Lewis *v.* Glenn, 84 Va. 947.

that, the subscription being in writing, and the defendant having been recognized as a subscriber, and shown to be such by the books of the company, his liability in respect of his unpaid balance was in the nature of a non-negotiable chose in action, founded on his contractual obligation, which ripened into a perfect obligation upon his default of payment after the call thus judicially made, and, as such, was assignable under the statute of Virginia quoted in the preceding section. Whatever may be thought of the reasoning of the court, its conclusion was obviously sound and just. It was in conformity with numerous decisions growing out of the same insolvency, both in the Federal and State courts.[1]

§ 3569. When Receiver or Assignee may Sue in Equity. — In a case in the Circuit Court of the United States for the district of Massachusetts, it was held by Mr. Circuit Judge Colt that the receiver of a foreign corporation properly brought a suit in equity in that jurisdiction to charge stockholders there resident;[2] but he evidently decided the question without consideration, and his decision seems to have been misconceived. It is perceived that it involves the solecism of there being a suit in equity supplementary to another suit in equity, and that too in a case where no supplemental aid of an equitable nature is required, but where the jurisdiction of a court of law is ample. On the contrary, it was seemingly well held in the District Court of the United States for the Eastern District of Missouri, in a case in bankruptcy, where the assignee in bankruptcy brought a suit in equity to charge a stockholder, that the bill would not lie, but that the proper remedy was for the court of bankruptcy to assess the stockholders, and for the assignee to proceed by an ordinary action to enforce the assessment.[3] The true theory is believed to be this: Where a case arises which presents some *legal obstacle to the prosecution of an action at law* against the stockholder by the receiver or assignee, then he may invoke the aid of equity,

[1] The cases are referred in the last note to § 3570, *post*, nearly all of which were decided in favor of the substituted trustee.

[2] Andrews *v.* Bacon, 38 Fed. Rep. 777.

[3] Myers *v.* Seeley, 1 Cent. L. J. 451. The text is believed to state the substance of the decision, which was not very fully reported.

in accordance with the doctrine laid down in a very well-considered case in the Court of Errors and Appeals of New Jersey, where it was said by Depue, J., that, independently of statutes, "it is well settled in England at the present time that the jurisdiction of chancery in aid of a judgment creditor extends no further than to property of such a nature and description as might have been seized by the process at law, if some legal obstacle had not been interposed. The assistance which the English courts of equity give to the assignee of the bankrupt or insolvent, to enable him to reach trust property or funds, is, by virtue of their ordinary jurisdiction in aid of legal rights conferred by acts of Parliament."[1]

§ 3570. Common-law Action Brought in Name of Corporation to Use of Receiver, Assignee, etc.—The well-known rule of common-law pleading is, that where an open account or other non-negotiable evidence of debt or chose in action has been assigned, and the assignee sues the debtor or obligor upon the contract, he must bring the action in the name of his assignor to his own use.[2] An assignment by a corporation of its share subscriptions, or rather of its right of action against its shareholders, to collect what remains unpaid on their share subscriptions, falls under this rule. Where the assignee brings an action against the shareholder, although to enforce an assessment made by the court superintending the administration of the estate of the insolvent corporation, he must, if the common-law system of procedure prevails in the particular forum, bring the action in the name of the corporation to his own use.[3] So, in Illinois where the common-law

[1] Hardenburgh *v.* Blair, 30 N. J. Eq. 645, 660, 661.

[2] New York Guaranty Co. *v.* Memphis Water Co., 107 U. S. 205, 214, and authorities cited.

[3] Glenn *v.* Marbury, 145 U. S. 499; quoting and following Glenn *v.* Busey, 5 Mackey (D. C.), 243. The Court of Appeals of Virginia seems to have held, as already intimated (*ante*, § 3578), that under a statute of Virginia the assignment made by the corporation to the trustees for the benefit of its creditors, in the case under consideration, passed the *legal title* to the trustees in whose place the trustee Glenn was substituted by the Virginia court. Lewis *v.* Glenn, 84 Va. 947. But this did not affect the conclusion of the Supreme Court of the United States

system of pleading prevails, the action is brought in the name of the corporation for the use of the receiver,[1] though cases are found in that State where the action was prosecuted by the receiver in his own name. This senseless rule of common-law pleading has been abolished by the modern codes of procedure, which have now been enacted by more than one-half of the States of the American Union. One of the leading provisions of these codes is, that every action shall be prosecuted *in the name of the real party in interest*, and that the real party in interest shall not be required to go through the senseless formality of prosecuting his action in the name of a party who himself could not sue, who is not even responsible for costs, but whose name is a mere *naked name of record*, like the John Doe and Richard Roe of the old actions of ejectment. A better illustration of this statement could not be made than to refer to many of these so-called Glenn cases, where, in various jurisdictions, Federal and State, — everywhere, it seems, except in the District of Columbia, — the substituted trustee Glenn either successfully prosecuted in his own name actions for the calls ordered by the Virginia court, or his

on the point of pleading in question, because that court has held that "whether an assignee of a chose in action shall sue in his own name or that of his assignor, is a technical question of mere process, and determinable by the law of the forum." Pritchard *v.* Norton, 106 U. S. 124, 130. Contrasting this decision with Lewis *v.* Glenn, 84 Va. 947, where it was held that the trustee might, both under and independently of the provision of the Code of Virginia of 1873, ch. 141, § 17, bring the action in his own name, — and where the court sustained the action brought by the substituted trustee in his own name, which was the common-law action of trespass on the case in *assumpsit*, — in the course of its reasoning in Glenn *v.* Marbury, *supra*, the Supreme Court of the United States held that no promise to pay *to the assignee* could be implied from the general authority which every stockholder is presumed to give the corporation to deal with its property in a lawful manner; and that the disability of a trustee to sue in his own name was not affected by the fact that the call was made by the court at the instance of a creditor, and that the trustee was specially authorized by it to collect the same; since in making the call the court simply acted in place of the company, which had failed to perform its duty. Glenn *v.* Marbury, *supra*.

[1] See for example Great Western Tel. Co. *v.* Gray, 122 Ill. 630.

right to prosecute was determined against him on other grounds.[1]

§ 3571. Judgment of Federal Court within the State will Furnish Foundation for Creditors' Bill in State Courts.— The judgments of the courts of the United States are regarded by the courts of the State within whose limits such Federal judgments are rendered, as "*domestic judgments;*" and therefore such a judgment, recovered against a corporation, will furnish a foundation for a creditor's bill, in like manner as though it had been recovered in a court of the State. For instance, a judgment against a corporation recovered in the Circuit Court of the United States for one of the Federal districts within the State of Wisconsin, will have the same force and effect in the respect under consideration in the courts of the State of Wisconsin as a judgment recovered in any of the superior courts of that State.[2]

[1] Hawkins *v.* Glenn, 131 U. S. 319 (error to Circuit Court of the United States for the eastern district of North Carolina); Glenn *v.* Semple, 80 Ala. 159; *s. c.* 60 Am. Rep. 92; Lehman *v.* Glenn, 87 Ala. 618; Semple *v.* Glenn, 91 Ala. 245; *s. c.* 24 Am. St. Rep. 894; 9 S. W. Rep. 265; Sayre *v.* Glenn, 87 Ala. 631; Morris *v.* Glenn, 87 Ala. 628; Glenn *v.* Williams, 60 Md. 93; Glenn *v.* Clabaugh, 65 Md. 65; Glenn *v.* Howard, 65 Md. 40; Glenn *v.* Savage, 65 Md. 40; McKim *v.* Glenn, 66 Md. 479; Glenn *v.* Orr, 96 N. C. 413; Howard *v.* Glenn, 85 Ga. 238; *s. c.* 21 Am. St. Rep. 156; Glenn *v.* Saxton, 68 Cal. 353; Glenn *v.* Dorsheimer, 23 Fed. Rep. 695; *s. c.* 24 Fed. Rep. 536; Glenn *v.* Springs, 26 Fed. Rep. 494; Glenn *v.* Scott, 28 Fed. Rep. 804; Glenn *v.* Soule, 22 Fed. Rep. 417; Glenn *v.* Foote, 36 Fed. Rep. 824.

[2] Ballin *v.* Loeb, 78 Wis. 404, 413; *s. c.* 47 N. W. Rep. 516; 11 L. R. A. 742. There seems to be some conflict of authority on this question, but the reasoning of Mr. Justice Orton in the case just cited, and also the following cases referred to by him, vindicate the proposition that a judgment of a court of the United States is a *domestic judgment* within the State where it is rendered. Adams *v.* Way, 33 Conn. 419; Turrell *v.* Warren, 25 Minn. 9. To the same effect are the following cases: Wandling *v.* Straw, 25 W. Va. 692, 705; Thompson *v.* Lee Co., 22 Iowa, 206; St. Albans *v.* Bush, 4 Vt. 58; *s. c.* 23 Am. Dec. 246; Barney *v.* Patterson's Lessee, 6 Har. & J. (Md.) 182; Embry *v.* Palmer, 107 U. S. 3; McCauley *v.* Hargroves, 48 Ga. 50; Williams *v.* Wilkes, 14 Pa. St. 228.

CHAPTER LXV.

PROCEEDINGS BY GARNISHMENT.

SECTION
3576. When debt due shareholder for his shares is attachable.
3577. When subject to garnishment under execution against corporation.
3578. An assessment must have been made and not paid.
3579. A subscription must have been payable without an assessment.
3580. And (subject to exceptions) the corporation must continue solvent.
3581. Whether a superadded statutory individual liability can be reached by garnishment.
3582. Defenses available to the garnishee.
3583. Alabama.
3584. Illinois.
3585. Louisiana.
3586. Mississippi.
3587. Missouri.

§ 3576. **When Debt Due Shareholder for His Shares is Attachable.** — There is judicial authority for the proposition that the unpaid subscription of a stockholder is *attachable*, the same as any other debt.[1] But this must be qualified by what is hereafter stated in this chapter.[2]

§ 3577. **When Subject to Garnishment under Execution against Corporation.** — If the principle is conceded that a separate action may be maintained against each shareholder to enforce his liability, then there seems no good reason why a *judgment creditor* of the corporation may not resort to the process of garnishment, in order to obtain satisfaction of his debt out of what may be due from the stockholder to the corporation on account of his stock, provided a call has been made by the directors, as hereafter stated.[3]

[1] Peterson *v.* Sinclair, 83 Pa. St. 250.

[2] *Post*, § 3578.

[3] Meints *v.* East St. Louis &c. Mill Co., 89 Ill. 48; Faull *v.* Alaska Gold & Silver Mining Co., 14 Fed. Rep. 657.

§ 3578. An Assessment must have been Made and not Paid. — But an attentive examination of the subject will lead to the conclusion that this can only be the case where two circumstances concur: 1. Where there has been an assessment by a corporation upon the stockholder, which assessment is unpaid. The reason is that such an assessment is necessary to give a right of action by the corporation against the stockholder, and the attaching creditor, proceeding by garnishment against the stockholder, stands in the shoes of the corporation,[1] and cannot maintain his garnishment unless the corporation could maintain an action.[2]

§ 3579. Or the Subscription must have been Payable without an Assessment. — But, of course, no assessment is necessary to let in the remedy by garnishment where the subscription, by its own terms, or by the terms of the charter or governing statute, is payable at a fixed time, and there has been a default on the part of the stockholder in paying it at such time.[3] Accordingly, it has been held that a person who, in consideration of the issue of stock in a corporation

[1] McDermott *v.* Donegan, 44 Mo. 85. That the attachment creditor stands in the shoes of the judgment defendant and can assert no other or higher rights than his against the garnishee, see Fessler *v.* Ellis, 40 Pa. St. 248; Dougherty *v.* Hunter, 54 Pa. St. 380.

[2] Lane's Appeal, 105 Pa. St. 49; *s. c.* 51 Am. Rep. 166; Brown *v.* Union Ins. Co., 3 La. Ann. 177, 183; Hannah *v.* Moberly Bank, 67 Mo. 678; Simpson *v.* Reynolds, 71 Mo. 594; Bingham *v.* Rushing, 5 Ala. 403; Universal Fire Ins. Co. *v.* Tabor, 16 Col. 531; *s. c.* 27 Pac. Rep. 890; McKelvey *v.* Crockett, 18 Nev. 238; Parks *v.* Heman, 7 Mo. App. 14. The only case with which the writer has met holding that unpaid balances under share subscriptions can be reached by garnishment without an assessment, is Re Glen Iron Works, 17 Fed. Rep. 324, which is plainly untenable. See Lane's Appeal, *supra*, where it is denied and criticised. So, in Minnesota where the sheriff brought a statutory action against a stockholder, which action seems to have been in the nature of a proceeding by garnishment, it was held that he could proceed only in right of the company, and that an averment that the company was insolvent and had totally abandoned the work for which it was created, did not excuse the failure to aver that a call had been made and had not been paid by the stockholder. Robertson *v.* Sibley, 10 Minn. 323.

[3] See Ruse *v.* Bromberg, 88 Ala. 619, 627; *s. c.* 7 South. Rep. 384; Davis *v.* Montgomery Furnace &c. Co., 8 South. Rep. 496.

to him, subscribes to its bonds, agreeing to pay in installments, is liable to garnishment by the creditors of the corporation, for the unpaid balance of such subscription.[1] But where there is a general statute allowing a stockholder a definite *period of grace* after notice of the assessment, he is not subject to garnishment, under a judgment against the corporation or otherwise, until this period of grace has expired. It was so held under a statute of Colorado,[2] providing that stockholders shall not be required to pay any installment upon the unpaid balance of their subscriptions until "*twenty days* after personal demand therefor, or in cases where personal demand is not made, within *thirty days* after a written or printed demand has been deposited in the post-office."[3]

§ 3580. And (Subject to Exceptions) the Corporation must Continue Solvent. — Subject to exceptions hereafter stated, the other condition which must concur, in order to let in the remedy by garnishment, is: 2. That the corporation continues solvent.[4] The reason is, that when insolvency supervenes, the unpaid subscriptions of the stockholders, in common with the other assets of the corporation, become a *trust fund* for the benefit of stockholders, which necessarily means for the benefit of *all* the stockholders. When, therefore, the corporation becomes insolvent, the amount due by its shareholders in respect of their several subscriptions cannot be seized by a creditor under an *attachment*, for the double reasons that, in order that such subscriptions should constitute a debt presently payable to the company, there must have been a call made, either by the directors of the company, by

[1] Davis *v.* Montgomery Furnace &c. Co., 8 South. Rep. 496.

[2] Mills' Ann. Stat. Col., § 480.

[3] Universal Fire Insurance Co. *v.* Tabor, 16 Col. 531; *s. c.* 27 Pac. Rep. 890.

[4] Hays *v.* Lycoming Fire Ins. Co., 98 Pa. St. 184. In this case, the corporation was a *mutual fire insurance company*, and it was held that, the company being solvent, the premium notes being assessable for the payment of the very debt in suit, and assessment having actually been made, and the money due thereon having been partially paid into the hands of one of the garnishees, it was to be treated as an ordinary debt, and subject to attachment as other debts.

order of a court of equity, or by other competent authority; secondly, that when such a call is made after insolvency, it is made for the benefit of all the creditors, and the fund thus sought to be collected cannot be diverted to a single creditor.[1]

§ 3581. Whether a Superadded Statutory Individual Liability can be Reached by Garnishment. — As the creditor proceeding by garnishment proceeds against the stockholder only *in right of the corporation*, it follows that, unless the corporation itself could maintain an action against the stockholder, the creditor *cannot* successfully *proceed* against him *by garnishment.*[2] It must equally follow that where the creditor proceeds against the stockholder in respect of a statutory, superadded, individual liability, and where such liability is not in the nature of assets of the corporation, but is a liability flowing (so to speak) directly from the stockholder to the creditor, — the creditor cannot proceed by garnishment. But even this principle may be changed under particular statutes. Accordingly, it has been held in the Circuit Court of the United States for the District of Vermont, under a statute of that State, providing that actions *founded on a contract*, express or implied, may be commenced by *trustee process*, which is the New England equivalent for process of garnishment, — that where the corporation seeks to enforce the liability of its directors, under another statute,[3] for contracting a corporate indebtedness in excess of the amount of capital paid in, he may proceed by trustee process.[4] Unless there is some thing in the statute of Vermont relating to trustee process, which is totally different from ordinary statutes relating to garnishment proceedings, this decision, so far as it allows this remedy, is misconceived. The whole discussion related to the question whether the obligation of the directors was one *founded in contract*, so as to be within the statute, or whether it

[1] Lane's Appeal, 105 Pa. St. 49, 65; *s. c.* 51 Am. Rep. 166, 171, 172; following the principle of Scovill *v.* Thayer, 105 U. S. 143, and denying the authority of Re Glen Iron Works, 17 Fed. Rep. 324.

[2] *Ante*, § 3578.

[3] Rev. Stat. Vt., § 3291.

[4] Field *v.* Haines, 24 Blatchf. (U. S.) 160; *s. c.* 28 Fed. Rep. 919.

was *penal.* It had already been decided by the Supreme Court of Vermont, whose decision on the question was binding on the Federal court, that in such a case the directors and stockholders became *joint debtors* with the company to its creditors.[1] It is not perceived, then, on what principle one joint debtor can be regarded as the "trustee" of the other joint debtor.

§ 3582. Defenses Available to the Garnishee. — In the proceeding under consideration, the plaintiff seeks merely to recover a debt alleged to be due from the garnishee to the corporation. He proposes to succeed to the rights of the company. It follows that whatever would defeat the company, in a suit against the stockholder to recover the alleged balance, will also be fatal to a recovery in a proceeding by garnishment.[2]

§ 3583. Alabama. — In Alabama this remedy was early given creditors by statute; but the court thrust itself in the way of the obvious purpose of the Legislature, by holding that a garnishee answering that he had *paid all calls* made by the president and directors of the corporation upon him, was entitled to his discharge; he could not, for the same reasons given by the Louisiana court,[3] under this process, be made to pay to the creditor that portion of his subscription as to which no calls had been made.[4] But this principle has been denied by the same court in a later case, and the garnishee was held *liable although no calls had been made,* and although, by the contract of subscription, the money was payable only upon the call of the company.[5] In an earlier case in the same State,[6] the garnishee answered that he had been informed, and believed, that the corporation had ceased to have any legal existence previous to the issuing of the garnishment. This was held equivalent to an assertion that the corporation was dissolved, and

[1] Windham Provident Inst. *v.* Sprague, 43 Vt. 502.

[2] See, for the general principle, Drake on Attachments, § 672. The doctrine of the text is found in an opinion of the Supreme Court of Missouri, written by Currier, J.; McDermott *v.* Donegan, 44 Mo. 85, 89.

[3] *Post,* § 3585.

[4] Bingham *v.* Rushing, 5 Ala. 403.

[5] Curry *v.* Woodward, 53 Ala. 371, 377.

[6] Paschall *v.* Whitsett, 11 Ala. 472.

upon this the court discharged him, — holding, in accordance with the old law,[1] that by the dissolution of a corporation the debts due to it were extinguished. But this doctrine, as elsewhere seen,[2] is obsolete, and has been overruled in the same State.[3] It has been held that several shareholders may be joined in the same writ, although their liability is *several.*[4] In a case of this kind, by leave of court, the garnishment was dismissed as to one of the two garnishees, and his name stricken from the process, upon plea by him that the process treated him as a *joint debtor* with the other, when he was separately indebted. The remaining garnishee excepted, and offered to file a written answer, to which the plaintiff objected, and required an oral answer, which was ordered at the next term, and the cause was continued from time to time, until the garnishee filed his written answer, and was afterwards examined orally. Under these circumstances, the court held that this garnishee could not afterwards object that the garnishment had been discontinued by the dismissal as to the other party, even if it had that effect, which was not conceded.[5] In 1889, a statutory provision authorizing a *judgment creditor* of a corporation to sue out a garnishment to reach unpaid subscription of any stockholder therein (Code, § 2972), was *amended by* allowing "any creditor" of the corporation to do this.[6]

§ **3584. Illinois.** — In this State the process of garnishment is available to the judgment creditor, in respect of the liability of the stockholder for unpaid stock *on which a call has been made;*[7] and under the corporation law of the State enacted in 1872,[8] making stockholders liable to creditors, etc., garnishee process lies *after judgment* against the corporation; and it is not necessary to proceed against the stockholders at the time of instituting suit against the corporation, as in garnishee proceedings under the attachment act.[9]

§ **3585. Louisiana.** — In Louisiana this remedy has, on general grounds, been conceded to the judgment creditor of a corporation, to enable him to reach moneys due the corporation by stockholders on

[1] Mumma *v.* Potomac Co., 8 Pet. (U. S.) 281.

[2] *Post,* Ch. 156.

[3] Curry *v.* Woodward, 53 Ala. 371.

[4] *Ibid.*

[5] *Ibid.*

[6] Ala. Act Feb. 26, 1889; Acts 1888–89, No. 111, p. 94.

[7] Meints *v.* East St. Louis &c. Mill Co., 89 Ill. 48.

[8] Illinois Corporation Act 1872, § 8.

[9] Coalfield Co. *v.* Peck, 98 Ill. 139.

account of their stock, *even though the directors had made no call* to which the stockholders had not responded; the court saying that the plaintiff might exercise against the debtors all the rights which the corporation might exercise against them.[1] But it has been subsequently held that, as to any unpaid portion of a stockholder's subscription for which the directors have not made a formal call, his liability could not be enforced by creditors of the company by process of garnishment; they must resort to a direct action. The company itself had no action against the stockholder without a formal call, and the creditor, whose right was derivative, flowing from the company, was in no better position.[2]

§ **3586. Mississippi.** — The process of garnishment seems to be available to creditors in Mississippi; and it has been held in such a proceeding that the creditor cannot make the defense that the company has never been legally incorporated unless he denies the incorporation under oath, as required by the statute of that State.[3]

§ **3587. Missouri.** — Proceedings by judgment creditors of corporations by garnishment against stockholders, to subject the amounts unpaid upon their stock subscriptions, have frequently been upheld in this State.[4] In such cases, the judgment creditor succeeds to the rights of the company, and whatever would defeat the company, in a suit brought by it to recover the alleged balance, will be fatal to a recovery against the stockholder in such a proceeding.[5] Therefore, the creditor cannot recover against a stockholder as *garnishee*, unless he shows that a *legal call has been made* upon the stockholders for unpaid stock,[6] or unless the indebtedness for stock is *otherwise due* according to the terms of his subscription.[7] Therefore, a sheriff, acting as *receiver* of the effects of a corporation by virtue of an appointment under the statute,[8] has no power, by suit in his own name, to enforce the liability of a stockholder to the corporation for unpaid stock which is not due according to the subscription, and for which no call has been made by the directors.[9] Outside of the question as

[1] Cucullu *v.* Union Ins. Co., 2 Rob. (La.) 571 (1842).

[2] Brown *v.* Union Ins. Co., 3 La. Ann. 177, 183.

[3] Saffold *v.* Barnes, 39 Miss. 399.

[4] McDermott *v.* Donegan, 44 Mo. 85.

[5] *Ibid.* See Drake on Attachments, § 672.

[6] Parks *v.* Heman, 7 Mo. App. 14.

[7] Hannah *v.* Moberly Bank, 67 Mo. 678; Simpson *v.* Reynolds, 71 Mo. 594.

[8] Wagner's Mo. Stat., p. 606.

[9] *Ibid.*

to the necessity of a call, it has been held in this State that where a party was induced to become a director of a company by receiving certain shares of stock as *full-paid*, which stock he subsequently sold, it was held that he might be garnished by a judgment creditor of the company to the extent of the proceeds of his stock.[1] In such a proceeding it has been held that a statement in the *denial* of the garnishee's answer, that a call upon the shareholder in respect of his shares had been duly made, is not admitted by the failure of the garnishee to reply, and that, when such a case has been tried as if the reply had been filed, and as if the issues had been properly made by the pleadings, the allegations in the answer of the garnishee will, after verdict, be treated as if formally denied.[2]

[1] Eyerman *v.* Krieckhaus, 7 Mo. App. 455.

[2] Parks *v.* Heman, 7 Mo. App. 14.

CHAPTER LXVI.

EXECUTIONS AGAINST STOCKHOLDERS.

ART. I. GENERALLY. §§ 3591–3599.
II. UNDER THE MISSOURI STATUTE. §§ 3602–3621.

ARTICLE I. GENERALLY.

SECTION
3591. Execution against the shareholders a creature of statute.
3592. The writ of *scire facias.*
3593. Registry of judgment against corporation not a lien against shareholder's property.
3594. English statutes providing for registry of shareholders, and giving creditors a right to inspect the register.
3595. Enjoining the creditor from executing his judgment against shareholders.
3596. Summoning the stockholder in an action against the corporation.
3597. Execution against corporation with clause for levy upon property of members.
3598. Motion under Kansas statute.
3599. Execution against stockholder under Massachusetts statutes.

§ 3591. Execution against the Shareholders a Creature of Statute. — We have already seen that by the common law the corporation is one person, and each of its shareholders another person. By that law a judgment against an individual can only be executed against the person or property of the individual named in the judgment; the execution must follow the judgment and run against the same person.[1] It follows that by the common law no execution can be sued out against a shareholder on a judgment recovered against the corporation. The conclusion is, that execution can only be had against a shareholder on a judgment recovered against the corporation where such a remedy is given by statute, and that the mode of obtaining it can only be that pointed out by the statute. In

[1] Lind. Comp. Law, 5th ed., 276.

every such case, with exceptions chiefly under early New England statutes,[1] there must be some sort of *supplementary proceeding* against the shareholder, in which he is called in by *notice* and given an opportunity to *show cause* why the judgment against the corporation should not be executed against him.[2]

§ 3592. The Writ of Scire Facias.—To give the stockholder such an opportunity to show cause was the real object of resorting to the writ of *scire facias*. "By the common law," says Sir Nathaniel Lindley,[3] citing the marginal authorities, "a judgment against A. cannot be executed against B. without a *scire facias*, which, though a judicial writ, is in the nature of an action, and may be pleaded to accordingly. So, before a judgment in the Chancery Division against a public officer [of a company] can be enforced against individual shareholders, an order against them personally must be obtained.[4] The object of the *scire facias* was technically to make the execution conformable to the judgment; but substantially its object was to give the person against whom the judgment was sought to be enforced, an opportunity of defending himself; for, *ex hypothesi*, he had not had that opportunity before."[5]

§ 3593. Registry of Judgment against Corporation not a Lien against Shareholder.—Provisions are very common in this country for the registry of judgments, in which case they become *liens*, for the length of time and under the conditions named in statutes, upon the property of the company. A similar provision exists in England; and it seems from the text of Sir Nathaniel Lindley that such a registration does not make the judgment a charge upon the property of the indi-

[1] See, for example, *post*, § 3596.

[2] Fell *v.* Burchett, 7 El. & Bl. 537.

[3] Lind. Comp. Law, 5th ed., p. 281.

[4] Vigers *v.* Pike, 8 Cl. & Fin. 562, 652; Healey *v.* Chichester &c. R. Co., L. R. 9 Eq. 148.

[5] See, generally, as to *scire facias*, Com. Dig. Pleader, 3 L.; Bac. Abr. Scire Facias; and the note to Underhill *v.* Devereux, 2 Wms. Saund. 71.

vidual shareholders, except possibly in those cases where it binds them individually without the issuing of a *scire facias*.[1]

§ 3594. English Statutes Providing for the Registry of Shareholders and Giving Creditors a Right to Inspect the Register.—"In order to enable a creditor, who has obtained judgment against a company, to discover the persons against whom such judgment may be executed, provision has been made by the various statutes relating to companies, compelling them to make periodical returns, or to keep registers, of the names and residences of their shareholders, and directing such returns or registers to be open for inspection."[2] There are analogous statutes in this country.

§ 3595. Enjoining the Creditor from Executing His Judgment against Shareholders.—Equity will not *enjoin* a creditor from executing his judgment against any shareholder or shareholders whom he may choose to select for that purpose, provided he acts in good faith;[3] and while a member who is also a creditor will not be so restrained,[4] yet it has been held that neither a judgment creditor nor a purchaser from him will be allowed to use the judgment for the dishonest purpose of aiding some members of the company against others.[5]

§ 3596. Summoning the Stockholder in an Action against the Corporation.—A statute of Massachusetts[6]

[1] Lind. Comp. Law, 5th ed., 281, 282; citing and comparing the following cases: Ex parte Ness, 5 Com. B. 155; Harris *v.* Royal British Bank, 2 Hurl. & N. 535; Hone *v.* O'Flahertie, 9 Ir. Ch. 119; Ex parte Thornton, L. R. 2 Ch. 171.

[2] Lind. Comp. Law, 5th ed., 282, adding the following note: "See 7 Geo. 4, ch. 46, § 4, *et seq.;* 7 Wm. 4 & 1 Vict., c. 16, §§ 9, 10, 36; and as to the mode of obtaining inspection, see Meader *v.* Isle of Wight Ferry Co., 9 W. R. 750 Ex., where a *mandamus* was held not necessary; Reg. *v.* Derbyshire &c. R. Co., 3 El. & Bl. 784, where a *mandamus* was obtained. As to examining the directors, see Dickson *v.* Neath &c. R. Co., L. R. 4 Ex. 87. See, also, R. S. C. Ord. 42 r., 32, *et seq.*, as to discovery in aid of execution."

[3] Green *v.* Nixon, 23 Beav. 530. See Morisse *v.* Royal British Bank, 1 Com. B. (N. S.) 67.

[4] Hardinge *v.* Webster, 1 Dr. & Sm. 101.

[5] Woodhams *v.* Anglo-Australian Co., 2 De Gex, J. & Sm. 162.

[6] Mass. Stat. 1851, ch. 315, § 1.

required a summons to be left with a stockholder of a corporation, before his property could be taken on execution against the corporation; but this was held not to prescribe any change in the writ or declaration, from the form before adopted in a suit against such corporation.[1]

§ 3597. Execution against Corporation with Clause for Levy upon Property of Members.—An early statute of Iowa[2] authorized an execution on a judgment recovered against a corporation, with a clause that it be levied upon the members of the corporation. The execution was required to follow the judgment, with this exception.[3] An execution, issued under this statute against the corporation, was leviable upon the property of the stockholder to the extent of his liability only.[4] A clause in a writ of *fieri facias* directing *its levy* upon the property of certain individual stockholders, does not make them "judgment creditors" within the meaning of the statutes relating to supplementary proceedings on execution.[5]

§ 3598. Motion under Kansas Statute.—Under the Kansas statute, providing[6] that when no corporate property can be found to levy on, "execution may be issued against any of the stockholders, ... but no execution shall issue . . . . except upon an order of the court in which the action, suit, or other proceeding shall have been brought, ... made upon *motion* in open court after reasonable notice in writing to the person sought to be charged, ... or the plaintiff . . . . may proceed by action to charge the stockholders,"—it is held that the *notice* must be *served* like an original summons, and that service outside the State will not confer jurisdiction.[7]

[1] Holyoke Bank *v.* Goodman Paper Man. Co., 9 Cush. (Mass.) 576.

[2] Iowa Stat. 1847, 103.

[3] Hampson *v.* Weare, 4 Iowa, 13; *s. c.* 66 Am. Dec. 116.

[4] Bayliss *v.* Swift, 40 Iowa, 648.

[5] Bailey *v.* Dubuque &c. R. Co., 13 Iowa, 97. For a proceeding supplementary to execution in which the court adjudged who were stockholders and in what manner each was liable, which was held not well taken, see Donworth *v.* Coolbaugh, 5 Iowa, 300.

[6] Kan. Comp. L. 1879, ch. 23, § 32.

[7] Howell *v.* Manglesdorf, 33 Kan. 194. The *notice* and subsequent proceedings were held *regular* in Wells *v.* Robb, 43 Kan. 201; *s. c.* 23 Pac. Rep. 148.

§ **3599. Execution against Stockholder under Massachusetts Statutes.** — A statute of Massachusetts, authorizing the levy of executions on judgments obtained against corporations on the body and goods of their members, has been already alluded to.[1] The court refused to extend such a statute, by construction, so as to permit a levy to be made under it upon the *lands* of the stockholder.[2] The execution which might have been served on the members, property, etc., must have been the same on which the officer made demand upon the officers of the corporation. A demand on the execution first issued did not authorize an arrest or levy upon an *alias*.[3] Where a creditor had *two demands*, one only of which the stockholders were liable to pay, and recovered a single judgment on both demands, he might yet have levied his execution on the personal property of a stockholder, to the amount of the demand which the stockholders were liable to pay.[4] If the only officer of a corporation who has any property has been adjudged liable as a stockholder, in a suit against the corporation for a debt, and judgment has been rendered, and execution issued accordingly, he cannot maintain an action against a deputy sheriff for seizing his property upon the execution, after demand made upon the corporation, and refusal to pay the same.[5]

ARTICLE II. UNDER THE MISSOURI STATUTE.

SECTION
3602. Remedy by motion under Missouri statute.
3603. The statute a substitute for a bill in equity.
3604. Is a proceeding in the same court which rendered the judgment.
3605. Motion against each stockholder is a separate proceeding.
3606. Service outside the State does not confer jurisdiction.
3607. Judgment rendered after legal dissolution of corporation will not support proceeding.
3608. Liability fixed by return of execution *nulla bona*.
3609. Evidence of corporate insolvency: return of *nulla bona*.

[1] *Ante*, § 3596.
[2] Child *v.* Coffin, 17 Mass. 64.
[3] Leland *v.* Marsh, 16 Mass. 389.
[4] Stedman *v.* Eveleth, 6 Met. (Mass.) 114.
[5] Lee *v.* Dearborn, 4 Allen (Mass.), 164.

SECTION
3610. What if execution against corporation returned before return-day.
3611. Return not presumed to be premature because not dated.
3612. Informalities waived by appearance.
3613. No jury trial.
3614. Appellate court will review the evidence.
3615. Whether the motion should be preserved in the bill of exceptions.
3616. Not necessary to take and save exception to the order disposing of the motion.
3617. Proceeding does not abate on death of stockholder pending appeal.
3618. Motion not maintainable against administrator of deceased stockholder.
3619. Burden of proof.
3620. Motion not maintainable after general assignment for creditors.
3621. Second motion, if dismissed, not fatal to recovery on first motion.

§ 3602. Remedy by Motion under Missouri Statute.—In Missouri a remedy is given by statute as follows: "If any execution shall have been issued against any corporation, and there cannot be found any property or effects whereon to levy the same, then such execution may be issued against any stockholders to the extent of the amount of the unpaid balance of such stock by him or her owned; provided, always, that no execution shall issue against any stockholder except upon an order of the court in which the action, suit, or other proceedings shall have been brought or instituted, made upon motion in open court, after sufficient notice in writing to the persons sought to be charged; and upon such motion such court may order execution to issue accordingly; and provided further, that no stockholder shall be individually liable in any amount over and above the amount of stock owned.[1] . . . . The clerk or other officer having charge of the books of any corporation, on demand of any officer holding any execution against the same, shall furnish the officer with the names, places of residence, so far as to him known, and the amount of liability of every person liable as aforesaid."[2] The proceeding authorized by this statute is characterized as a supplemental and not an original proceeding,—a proceeding "merely auxiliary to a former proceeding *in the same court*, which proceeding has resulted in a judgment in that court against the corporation, followed by the issuance of a barren execution."[3]

[1] R. S. Mo. 1879, § 736; *Id.*, 1889, § 2517.

[2] *Ibid.*, 1879, § 737; *Id.*, 1889, § 2518.

[3] Paxon *v.* Talmage, 87 Mo. 13; affirming *s. c.* 14 Mo. App. 586. As to the construction of constitutional provisions of Missouri (Const. Mo.

§ 3603. The Statute a Substitute for a Bill in Equity. — It has been said: "This motion takes the place, under the statutory provision, of the suit in equity, at common law, to reach assets in the hands of the stockholder; and, to a certain extent, should be treated as a petition."[1] It gives a judgment creditor of a corporation, where corporate property cannot be found upon which to levy his execution, the right to an execution against a stockholder, to the extent of the amount of the *unpaid balance* of his stock.[2] In another case it is said that "the process against the defendants Seligman was, in substance and effect, a process of garnishment; since it sought to appropriate to the demand of the plaintiff whatever debt they might owe to the judgment debtor, the corporation."[3]

§ 3604. Is a Proceeding in the Same Court Which Rendered the Judgment. — The motion or petition for an execution under this statute can only be preferred in the court in which the judgment against the corporation was rendered: it will be demurrable if filed in another court.[4] Moreover, if filed in another court, and the shareholder has filed an answer to it, and the petitioner has moved to strike out certain parts of such answer, the court will properly treat the motion to strike out as a demurrer, and will properly rule that as such it reaches back to and questions the sufficiency of the petition. This rule at common law still prevails under the codes of procedure; since it is not a technical rule, but one necessarily incident to every system, and which may be successfully invoked, whenever the court is advised, by demurrer or motion, of any substantial error or defect in the pleading, such as would render a verdict nugatory if founded upon it.[5]

§ 3605. Motion against Each Stockholder is a Separate Proceeding. — It seems that several motions against several stockholders, by a single judgment creditor, to obtain satisfaction of the same judgment, are *several proceedings* against the stockholders

1865, art. 8, § 6), and the statutes of that State (Gen. Stat. Mo. 1865, p. 328, § 111), with reference to the individual liability of stockholders, see McClaren *v.* Franciscus, 43 Mo. 452.

[1] Erskine *v.* Loewenstein, 82 Mo. 301, 305, *per* Philips, Com.

[2] Fogg *v.* Blair, 139 U. S. 118.

[3] Wilson *v.* St. Louis &c. R. Co., 108 Mo. 588; *s. c.* 32 Am. St. Rep. 624; 18 S. W. Rep. 286, 294.

[4] Paxon *v.* Talmage, 87 Mo. 13; *s. c.* 14 Mo. App. 586; Allen *v.* Benton, 9 Mo. App. 578.

[5] Paxon *v.* Talmage, *supra.*

separately; and accordingly where a number of such motions were made, and issues were raised by each stockholder separately, and all the issues were sent to a referee, who reported upon the issues under each motion severally, and exceptions were filed by each stockholder separately, and were sustained by the court in separate orders, and a distinct bill of exceptions for each case was taken by the plaintiff and signed by the judge, — it was held that a writ of error, bringing up all the proceedings in one transcript, was erroneous.[1]

§ 3606. Service Outside the State does not Confer Jurisdiction. — Such a motion for an execution against a stockholder is so far in the nature of an original proceeding, that a service on the stockholder of the notice of the motion outside the State will not confer jurisdiction on the court to make the order awarding execution.[2]

§ 3607. Judgment Rendered after Legal Dissolution of Corporation will not Support Proceeding. — It is scarcely necessary to suggest that a judgment rendered against the corporation, after it has legally ceased to exist as such, being a *void judgment*, will not support any supplementary proceeding against a stockholder, by motion for execution or otherwise. It was accordingly held that where a judgment was recovered against a corporation, after its *charter had expired by statutory limitation*, the judgment could not support a motion for execution under the Missouri statute.[3]

§ 3608. Liability Fixed by Return of Execution Nulla Bona. — The Missouri statute was adopted from the following English statute: "If any execution, either at law or in equity, shall

[1] Marshall *v.* Taylor, 4 Mo. App. 590.

[2] Wilson *v.* St. Louis &c. R. Co., 108 Mo. 588; *s. c.* 32 Am. St. Rep. 624; 18 S. W. Rep. 286; Wilson *v.* Seligman, 144 U. S. 41; affirming *s. c.* 36 Fed. Rep. 154. So held under the Kansas statute, which is substantially the same as that of Missouri. Howell *v.* Manglesdorf, 33 Kan. 194. This *necessarily involves* the conclusion that a non-resident stockholder is in no sense a party to an action against the corporation to which he belongs, so as to obviate the necessity of proceeding against him as a non-resident, on an application for execution against him on a judgment against the corporation, under Rev. Stat. 1879, § 736. So held in Wilson *v.* St. Louis &c. R. Co., *supra.*

[3] Scanlan *v.* Crawshaw, 5 Mo. App. 337; Buckland *v.* Nies, 8 Mo. App. 587.

have been issued against the property or effects of the company, and if there cannot be found sufficient whereon to levy such execution, then such execution may be issued against any of the shareholders to the extent of their shares respectively in the capital of the company not then paid up." [1] The construction of the English statute on the point under consideration was established by the following opinion by Baron Alderson: "The construction of the act is very plain. It says that 'if any execution, etc., shall have issued against the property or effects of the company,' which has been done in this case, 'and if there cannot be found sufficient whereon to levy such execution,'— and that fact is ascertained the moment the sheriff has returned *nulla bona*,—'then such execution may be issued against any of the shareholders to the extent of their shares respectively in the capital of the company not then paid up,'—that is, the persons who are shareholders at the time the execution against the property or effects of the company is found to be ineffectual. But in order that no injustice may be done, and that it may be ascertained who those persons are, notice must be given, so that the persons against whom proceedings are taken may have an opportunity of showing that they were not shareholders at the time of the return of *nulla bona*. The object of requiring notice is merely to do justice to the class who are sought to be charged as shareholders at the time of the return of *nulla bona;* any other construction would lead to an evasion of the act." [2] Now, it is a settled principle in the jurisprudence of Missouri, where the statute of another State or country is re-enacted in that State, to place the same construction upon such statute that it had at the time of its adoption received in the superior courts of the State or country from which it was taken.[3] Following this rule of construction, and in view of other considerations stated at length in its opinion, the Supreme Court of Missouri hold that, under the Missouri statute, the liability of the stockholder is measured by the number of shares held by him *at the return of the execution*, and not by the number which he held *when the motion was filed*.[4] The liability thus fixed by the return of *nulla bona* cannot be cast off by a trans-

[1] Stat. 8 & 9 Vict., ch. 16, § 36.

[2] Nixon *v.* Green, 11 Exch. 550. On appeal to the exchequer chamber, this decision was affirmed. 3 Hurl. & N. 686. See, also, Nixon *v.* Brownlow, 3 Hurl. & N. 686.

[3] Skouten *v.* Wood, 57 Mo. 380.

[4] Skrainka *v.* Allen, 76 Mo. 384, 391; reversing *s. c.* 7 Mo. App. 434.

fer of the stock, or by the subsequent acquisition of a claim against the corporation, or in any way, unless by establishing a *bona fide* indebtedness of the corporation to him, existing at the time when the return of *nulla bona* was made.[1] A defense that, at the time of the filing of the motion, the defendant was a creditor of the corporation to an amount exceeding the demand of the judgment creditor, is therefore ineffectual.[2]

§ 3609. Evidence of Corporate Insolvency: Return of Nulla Bona. — A return of *nulla bona* on the execution issued to the sheriff of the county in which the judgment was rendered against a corporation, makes a *prima facie* case in a proceeding by motion against a stockholder.[3] But a return of *nulla bona* on an execution against the corporation is not necessary to support a motion for execution against a stockholder: it may be shown, by *any competent evidence*, that the corporation has no goods on which a levy can be made.[4] If some property has been found and levied upon, but not enough to satisfy the execution, and there is a return of "no *other* goods, chattels, or real estate found," etc., this will support a motion for execution against a stockholder.[5]

§ 3610. What if Execution against Corporation Returned before Return-day. — It seems that if the execution against the corporation is in fact returned before the return-day fixed by law,

[1] Coquard *v.* Prendergast, 35 Mo. App. 237.

[2] *Ibid.* Another consequence is, according to the interpretation of the English statute, that not only all persons who have ceased to be shareholders before judgment against the company has been recovered, but also all who have ceased to be so after that time, but before it has been ascertained that execution against the company on such judgment will prove ineffectual, are wholly exempt from liability to the judgment creditor. Nixon *v.* Green, 11 Exch. 550; *s. c.* affirmed, 3 Hurl. & N. 686; Nixon *v.* Brownlow, 3 Hurl. & N. 686. See *post*, § 3811.

[3] Union Savings Association *v.* Seligman, 11 Mo. App. 142; *post*, § 4363.

[4] Marks *v.* Hardy, 12 Mo. App. 595; *s. c.* affirmed, 86 Mo. 232; Knight *v.* Frost, 14 Mo. App. 331. In this last case it was held that it will be sufficient if it be shown that execution issued against the corporation and that there was no property whereon to levy it, though the return of *nulla bona* on the execution be made before the return-day; but it is submitted that this view was overruled by the supreme court in the case of Marks *v.* Hardy, 86 Mo. 232, which was subsequently decided.

[5] Marks *v.* Hardy, 86 Mo. 232, 237; affirming *s. c.* 12 Mo. App. 595.

the return will not support a motion for execution against the shareholder.[1]

§ 3611. Return not Presumed to be Premature Because not Dated. — But, in such a case, the return will not be presumed to have been premature merely from the fact that it is not dated, or that it does not show when it was in fact lodged with the clerk. In such a case the presumption is, that the execution was deposited with the clerk on the return, and not before, and so the fact will be taken to be for the purposes of the motion against a stockholder.[2]

§ 3612. Informalities Waived by Appearance. — In a proceeding by motion under the Missouri statute for execution against a stockholder, the fact that the *motion* and *notice* of the same to the stockholder were not *entitled* of the proper court, is not ground for a reversal, where the court had jurisdiction and the defendant appeared.[3]

§ 3613. No Jury Trial. — In such a proceeding the parties are not entitled to a trial by jury.[4]

§ 3614. Appellate Court Will Review the Evidence. — As there is no jury trial,[5] the parties are not required to ask for instructions or declarations of law in order to secure an appropriate appellate review of the proceeding; but, where all the evidence is preserved in the bill of exceptions, an appellate court will review the evidence in a case in equity, and decide the case both on the law and the facts.[6]

§ 3615. Whether the Motion should be Preserved in the Bill of Exceptions. — Under the system of procedure in vogue in

[1] Marks *v.* Hardy, 86 Mo. 232, 238; affirming *s. c.* 12 Mo. App. 595.

[2] Marks *v.* Hardy, 86 Mo. 232, 238. See the observations on this particular return in Knight *v.* Frost, 14 Mo. App. 331, 339, where it was said by Bakewell, J., that the return was "quite regular."

[3] Schaeffer *v.* Jecko, 6 Mo. App. 592.

[4] Marks *v.* Hardy, 12 Mo. App. 595; *s. c.* affirmed, 86 Mo. 232; Erskine *v.* Loewenstein, 82 Mo. 301; affirming *s. c.* 11 Mo. App. 595; Schaeffer *v.* Phœnix Brewery Co., 4 Mo. App. 115, 119. This is in accordance with the general rule in Missouri as to all proceedings by motion. Hensley *v.* Baker, 10 Mo. 157, 158.

[5] See last section.

[6] Erskine *v.* Loewenstein, 11 Mo. App. 595; Coquard *v.* Prendergast, 35 Mo. App. 237.

Missouri, a written motion filed in a cause is no part of the *record proper*, and hence, in order to bring it to the attention of an appellate court, it must be embodied in a bill of exceptions.[1] Nor will the mere fact that the clerk sets out the motion in that portion of the transcript outside of the bill of exceptions, enable the appellate court to regard it as part of the record, — it being no part of the record proper, and the rule being that the clerk cannot make everything a part of the record which he sees fit to incorporate into the transcript.[2] An examination of the cases just cited will show that this principle has been applied to almost every species of motion made in the course of a judicial proceeding. Applying this rule, it has been held that a proceeding by motion for execution against a stockholder, under the Missouri statute, is in no sense the institution of an independent suit, but a mere supplementary proceeding in aid of the execution against the corporation.[3] It has been held in the Circuit Court of the United States that, a proceeding under this statute being a mere "sequence, dependency, or supplementary proceeding" for enforcing a judgment against the corporation, it cannot be *removed to the Federal court* upon application of a non-resident stockholder who is brought in by the motion.[4] From these premises the St. Louis Court of Appeals reached the conclusion "that motions of this character stand upon the same footing as other motions made in a case, and cannot be considered by appellate courts in reviewing the action of the trial court, unless they are made part of the record by being incorporated in the bill of exceptions." Nor was it enough that the motion was set out in full by the clerk in the transcript.[5] But this rule is extremely technical and destitute of any underlying support in common sense. It is a fact that the legal profession in Missouri have never been able to learn it, as often as it has been reiterated. It is especially senseless when applied to a proceeding

[1] Loudon *v.* King, 22 Mo. 336; Corby *v.* Tracy, 62 Mo. 511, 515; State *v.* Wall, 15 Mo. 208; Blount *v.* Zink, 55 Mo. 455; Brown *v.* Foote, 55 Mo. 178; State *v.* Batchelor, 15 Mo. 207; Christy *v.* Myers, 21 Mo. 112; Kohn *v.* Lucas, 17 Mo. App. 30; McCarthy *v.* McGinnis, 76 Mo. 344; State *v.* Gee, 79 Mo. 313.

[2] United States *v.* Gamble, 10 Mo. 457, 459; Jefferson City *v.* Opel, 67 Mo. 394; Ober *v.* Railroad Co., 13 Mo. App. 84.

[3] Allen *v.* Benton, 9 Mo. App. 579; *s. c.* affirmed on this point, 79 Mo. 165, 166.

[4] Webber *v.* Humphreys, 5 Dill. (U. S.) 227.

[5] Kohn *v.* Lucas, 17 Mo. App. 29; Bank of North America *v.* Fletcher, 15 Mo. App. 272.

by motion against a stockholder under this statute, which proceeding is, in a large sense, an independent supplementary proceeding. It would, therefore, be much better to regard the motion as the original pleading in the proceeding, and to allow it to stand in the place of a petition in an original action. In fact, it is the frequent practice in that State to treat it as such, and to file a formal answer to it. The question came before the Supreme Court of Missouri, and, while regarding it as a "serious question," they gave the appellant "the benefit of this mere doubt," and held that it was sufficient that the motion was set out in the transcript, without being incorporated in the bill of exceptions.[1]

§ 3616. Not Necessary to Take and Save Exception to the Order Disposing of the Motion.—This proceeding is so far assimilated to an original proceeding that it is not necessary to take and save an exception to the order of the court which finally disposes of the motion, awarding or denying the execution; but it will be sufficient that a *motion for new trial* is filed within four days, and if it be overruled, an exception saved to the ruling, as in ordinary actions.[2] So, if the court overrules the motion, it is not necessary for the movant to take and save an exception to the ruling of the court, in order to have the ruling reviewed by appeal or error. The court say: "The refusal of the court to grant the motion is a finding of the issue for the defendant. The remedy for the error of the court in making such finding is by motion for new trial, and exception, at the time, to the action of the court in overruling this motion."[3]

§ 3617. Proceeding does not Abate on Death of Stockholder Pending Appeal.—If the motion is prosecuted to judgment, so to speak,—that is, if the court awards an execution against the stockholder and he appeals from this order, and, pending the appeal, dies,—the proceeding does not thereby abate, notwithstanding the fact that, under the administration law, an execution cannot be issued against the estate of a deceased person.[4]

[1] Erskine *v.* Loewenstein, 82 Mo. 301; affirming *s. c.* 11 Mo. App. 595.

[2] Allen *v.* Benton, 79 Mo. 165; reversing on this point, *s. c.* 9 Mo. App. 579; commented upon in Bank of North America *v.* Fletcher, 15 Mo. App. 272.

[3] Erskine *v.* Loewenstein, 82 Mo. 301, 305; affirming *s. c.* 11 Mo. App. 595.

[4] Marks *v.* Hardy, 86 Mo. 232; affirming *s. c.* 12 Mo. App. 595.

§ 3618. Motion not Maintainable against Administrator of Deceased Stockholder. —Under the statutes of Missouri an execution does not run against an executor or administrator, in respect of the decedent's estate but a person having a judgment against such an estate must file it in the probate court, and have it there established as a claim against the estate, and paid in due course of administration.[1] Now, the motion against the stockholders of insolvent corporations, which is familiar to the law of that State, is a motion *for execution.*[2] It is accordingly held that a motion under this statute cannot be maintained against the administrator of a deceased stockholder, but that the claim must be preferred like other claims in the probate court.[3]

§ 3619. Burden of Proof.—In a proceeding by motion against a stockholder under the Missouri statute, the burden is *on the judgment creditor* to show that the stock was *unpaid.*[4]

§ 3620. Motion not Maintainable after General Assignment for Creditors.—After an assignment by a corporation of all its assets for the benefit of its creditors, a particular creditor cannot maintain a motion for an execution against a particular stockholder; since the right of action is vested exclusively in the assignee.[5]

§ 3621. Second Motion, if Dismissed, not Fatal to Recovery on First Motion.—If the judgment creditor of the corporation has given notice of his motion to a stockholder on a *nulla bona* return on the execution, the fact that he has caused a second execution to issue against the corporation and given a second notice to the same stockholder, is not necessarily fatal to his recovery on the first motion, if he has dismissed his second motion.[6]

[1] Rev. Stat. Mo. 1879, § 191; 1 *Id.*, 1889, § 190.

[2] *Ibid.*, § 736.

[3] Cummings *v.* Wright, 11 Mo. App. 348.

[4] Mechanics' Savings Institution *v.* Potthoff, 9 Mo. App. 574.

[5] Lionberger *v.* Broadway Savings Bank, 10 Mo. App. 499, 513; Eppright *v.* Nickerson, 78 Mo. 482; Boeppler *v.* Menown, 17 Mo. App. 447; Franklin *v.* Menown, 10 Mo. App. 570; Menown *v.* Crawford, 10 Mo. App. *574; Franklin *v.* Menown, 11 Mo. App. 592; denying the *dictum* of Gantt, P. J., in Shultz *v.* Sutter, 3 Mo. App. 137.

[6] Knight *v.* Frost, 14 Mo. App. 331; distinguishing Ramage *v.* Clements, 4 Bush (Ky.), 161; and Turner *v.* Davis, 48 Conn. 397.

CHAPTER LXVII.

QUESTIONS OF PROCEDURE.

ART. I. QUESTIONS OF PLEADING. §§ 3625–3645.
II. QUESTIONS OF EVIDENCE. §§ 3650–3665.
III. OTHER QUESTIONS OF PROCEDURE. §§ 3669–3676.

ARTICLE I. QUESTIONS OF PLEADING.

SECTION
3625. Joinder of different causes of action against stockholder.
3626. Necessity of pleading the statute creating the liability.
3627. Averment of the facts on which the statute predicates the liability.
3628. Manner of alleging indebtedness of corporation.
3629. Averments as to time when debt contracted.
3630. Plaintiff's allegations where the liability is for unpaid shares.
3631. Allegations of exhausting legal remedies against corporation.
3632. Averment of insolvency or dissolution.
3633. Averment of the amount of stock held by defendant.
3634. Averment of the power of the corporation to issue the shares.
3635. Allegation that the shares are assessable.

SECTION
3636. Not necessary to aver want of knowledge that the shares were not paid for.
3637. Averment of a call.
3638. The same, in statutory action by sheriff in lieu of garnishment.
3639. Not necessary to aver issue and delivery of certificate.
3640. Not necessary to aver that all the stock was not subscribed.
3641. Not necessary to aver how the defendant became a stockholder.
3642. Sufficiency of averment in actions by receiver against individual shareholders.
3643. When not necessary to declare against the stockholders as partners.
3644. The prayer for relief.
3645. Common-law action brought by stockholder in name of corporation.

§ 3625. Joinder of Different Causes of Action against Stockholder. — The question what causes of action against stockholders can be joined must be referred to theories of pleading obtaining in the particular forum, which in many jurisdictions are influenced or governed by the modern codes

of procedure. It was held in one case in the Supreme Court of New York at special term, that the individual liability of the same persons as stockholders for the same debt, under a clause of the governing statute making them liable for debts due *laborers*, etc., did not constitute a different cause of action from an action against *trustees*, under another provision of the statute for failing to make and *publish* a prescribed *annual report* of the condition of the corporation.[1] At a later term it was held in the same court, by another judge, that a cause of action to charge the stockholders in a corporation formed under the same statute,[2] on the ground that the *subscriptions had not been paid in and a certificate filed*, as prescribed by section 10, could not be united with a cause of action to charge the same persons as *trustees* for not having *published the annual report* of the condition of the corporation prescribed by section 12.[3] So, where the complaint in an action against a director and stockholder of such a company sought to charge him for a debt of the company, on the grounds that he had not paid the whole of his subscription to the stock, and that, as director, he had signed a false annual report, it was held that the complaint *stated but one cause of action*, and therefore defendant could set up in defense that he was a creditor of the company.[4]

§ 3626. Necessity of Pleading the Statute Creating the Liability.— By the common law the members of a corporation are not individually liable for the corporate debts. When, therefore, the liability is created by a special charter which is a private statute, it must be pleaded in the action or bill.[5] Accordingly, where a bill in chancery was brought against the individual members of a corporation for the payment of

[1] Sterne *v.* Herman, 11 Abb. Pr. (N. S.) (N. Y.) 376.

[2] The New York Manufacturing Act of 1848.

[3] Mappier *v.* Mortimer, 11 Abb. Pr. (N. S.) (N. Y.) 455.

[4] Richards *v.* Kingsley, 14 Daly (N. Y.), 334; *s. c.* 12 N. Y. St. Rep. 125; again, 14 N. Y. St. Rep. 701.

[5] Middletown Bank *v.* Russ, 3 Conn. 135; *s. c.* 8 Am. Dec. 164; Perdicaris *v.* Trenton &c. Bridge Co., 29 N. J. L. 367.

a debt from the corporation without setting forth or counting on the act of incorporation by which alone the members were made individually liable, — it was held that the bill could not be sustained.[1] The rule is the same where the corporation itself brings the action to recover assessments. Here, under the rules of the common law, the declaration should set out the act of incorporation; it is not sufficient to state that the defendant agreed to pay the amount sued for, according to the provisions of the charter. But it should be carefully kept in mind that in some jurisdictions this principle is changed by statutes, which require the courts to take *judicial notice* of all acts of the Legislature, including private, local, and special acts. In such a case it would not be necessary to plead the statute, for the court would be bound to take notice of it.[2]

§ 3627. Averment of the Facts on Which the Statute Predicates the Liability. — Where the liability of the stockholder depends upon the failure of the corporation, its officers or stockholders, to comply with some statutory requirement, it is incumbent on the plaintiff to allege such failure; it is not necessary for the defendant to assume the burden of proving that such default had not taken place.[3] Thus, in Massachusetts it was not necessary for the persons summoned as stockholders in an action against the corporation, to file an answer specifically denying that the corporation had failed to comply with the statutes of the Commonwealth concerning corporations; but it was incumbent upon a plaintiff who sought to charge them with the corporate debts, to prove that the corporation had failed to comply with some one of the requisites of the statutes by the omission of which stockholders are rendered liable.[4] So, in Illinois in an action against stockholders to charge them under a statute making the stockholders of corporations of a given class liable to

[1] Perdicaris *v.* Trenton Bridge Co., 29 N. J. L. 367.

[2] For what is a sufficient averment of such a statute, see Rider *v.* Fritchey, 49 Ohio St. 285; *s. c.* 30 N. E. Rep. 692.

[3] Sherman *v.* Smith, 20 Ill. 350.

[4] Taylor *v.* New England &c. Co., 4 Allen (Mass.), 577.

its creditors for debts contracted before the *whole amount of capital stock*, fixed and limited by the company, shall have been *paid in* and a *certificate therefor filed*, etc., but limiting the liability of the stockholders to an amount equal to the stock held by them severally, — in order to charge a particular stockholder, it is, of course, necessary to aver how *much stock* was held by him.[1] In like manner, if it is intended to hold the stockholder liable under another section of the same statute, which creates a personal liability on the part of the stockholders for debts due from the corporation to their laborers, servants, or apprentices, the plaintiff must aver that the debt is due from the company to its laborers, servants, or apprentices.[2] So, if it is sought to charge him, under another provision, for the liability imposed in case the company contracts debts in excess of the amount of its capital stock, the plaintiff must, of course, aver that the debt sued for was contracted by the company after it has become indebted to the extent of its capital stock.[3] So, where the individual stockholder is liable for precisely that proportion of the whole notes of the bank in circulation which his shares bear to the whole capital stock, it is necessary that the *declaration* should contain an averment of the whole amount of outstanding, unredeemed notes.[4] So, where the charter of an insurance company provided that in all cases of losses exceeding the means of the corporation, each stockholder shall be held liable to the amount of unpaid stock held by him, it was held that a declaration was bad, which did not allege that the losses or liabilities of the company exceeded its assets.[5]

§ 3628. Manner of Alleging Indebtedness of Corporation. In an action by the judgment creditor of a corporation, to recover from a stockholder, upon his individual liability, a debt due by the corporation, a *general averment* of the recovery of a judgment against the corporation, and that such judgment is unpaid, is a sufficient statement of the indebtedness of the

[1] Sherman *v.* Smith, 20 Ill. 350.
[2] *Ibid.*
[3] *Ibid.*
[4] Robinson *v.* Lane, 19 Ga. 337.
[5] Blair *v.* Gray, 104 U. S. 769.

company to the plaintiff.[1] Under some schemes of statutory liability it is not enough to allege a judgment and an unsatisfied execution against the corporation. The right to proceed against the stockholder may depend upon the date at which the debt was contracted,[2] or the length of time which has since elapsed,[3] or the nature of the debt, as a debt due laborers, etc.[4] In such cases the plaintiff must allege a cause of action on the original demand, of such a nature as entitles him to the relief sought against the stockholder.[5] Thus, where that fact is material, the plaintiff must aver that the defendants were stockholders when the debt was contracted.[6] In Illinois, it will not be a good defense that it was not accompanied with an *affidavit*, if it was otherwise sufficiently proved.[7] It was held in a leading case that the declaration in an action against a stockholder for a corporate debt, under a charter making the stockholders individually liable for debts, where judgment has been recovered therefor against the corporation, and execution thereon has been returned unsatisfied, or where the corporation has been dissolved, need only show a debt due from the corporation, that the defendant was a stockholder at the time, that judgment has been recovered against the corporation, and execution returned unsatisfied, or that the corporation has been dissolved; and need not show a debt from the defendant to the plaintiff.[8]

[1] Miller *v.* White, 8 Abb. Pr. (N. S.) (N. Y.) 46. Where a complaint, in an action against the shareholders of a *joint-stock company* brought under the New York statute (Laws 1853, 283), averred that the defendants were all shareholders in said association during the year 1857; that, while they were such shareholders, an action was properly commenced on such demand against said association; that judgment was obtained, execution issued, and returned unsatisfied,—it was held that this presented a good cause of action, and that a demurrer thereto for insufficiency was frivolous. Witherhead *v.* Allen, 28 Barb. (N. Y.) 661.

[2] *Ante*, § 3169, *et seq.*

[3] *Post*, § 3768.

[4] *Ante*, § 3141, *et seq.*

[5] It has been held that alleging that the company became indebted to plaintiff for goods sold, without alleging a sum now due or a breach in any form, is not enough, even where judgment and execution unsatisfied are alleged. Witherhead *v.* Allen, 4 Abb. App. Dec. (N. Y.) 628.

[6] Young *v.* New York & Liverpool &c. Co., 15 Abb. Pr. (N. Y.) 69.

[7] Alling *v.* Wenzell, 27 Ill. App. 511.

[8] Freeland *v.* McCullough, 1 Denio (N. Y.), 414; *s. c.* 43 Am. Dec. 685.

§ 3629. Averments as to Time when Debt Contracted.—Where the liability of the stockholder depends upon the time when the debt was contracted, of course this must be alleged by the plaintiff. Thus, where the statutory liability of the stockholders is only for debts contracted by the corporation during the period when they were stockholders, the declaration must charge that the debt sued for was so contracted.[1] So, where the statute exonerates the stockholders from personal liability, unless the action is brought against them *within one year* after the debt of the corporation became due, the time when the debt became due must be averred.[2]

§ 3630. Plaintiff's Allegations where the Liability is for Unpaid Shares.—Without regard to the form of liability or to the mode of procedure, it is, of course, necessary for the plaintiff to allege that the person sought to be charged as a *shareholder is, in fact, such,*[3] and that his shares are assessable, or that something is due from him in respect of them.[4] An *assignee* of a right of action must *plead his title;* and accordingly, where an action of this kind is brought by an *assignee* of the company, the complaint must show that the company's obligation to deliver the stock, as well as the defendant's agreement to pay for it, was *transferred* to plaintiff.[5] It has been held that where a *stockholder who is a creditor* of the corporation seeks to recover his debt from another stockholder who has not paid up his subscription, the plaintiff must aver and prove that the plaintiff has paid up his whole subscription to the stock, and, also, that the defendant was a stockholder of the corporation at the time the debt was contracted, and that he has not paid up his subscription. And to this end, the defendant is entitled to a *bill of particulars.*[6]

[1] Hooker *v.* Kilgour, 2 Cin. Sup. (Ohio) 350.

[2] Tarbell *v.* Page, 24 Ill. 46.

[3] See, for instance, Donworth *v.* Coolbaugh, 5 Iowa, 300; Weber *v.* Fickey, 47 Md. 196.

[4] *Post,* § 3635.

[5] Minneapolis Harvester Works *v.* Libby, 24 Minn. 327.

[6] Weber *v.* Fickey, 47 Md. 196. For an *averment* which was held *bad* on several grounds, see Banty *v.* Buckles, 68 Ind. 49.

§ 3631. Allegations of Exhausting Legal Remedy against Corporation. — If the governing statute opens the road of the creditor against the stockholder only in cases where the creditor has exhausted his remedy at law against the corporation, he must obviously allege that he has prosecuted his demand to judgment against the corporation, and has sued out an execution thereon, which has been returned *nulla bona*. Where the proceeding against the stockholder is in the nature of a creditor's bill, this is necessary, by the principles of equity procedure.[1] In strictness, it is not sufficient to allege a return of *nulla bona*, but it is necessary to allege *that the corporation is insolvent*, or that it has no assets out of which the judgment can be satisfied, — and the return of *nulla bona* will be admissible as *prima facie* evidence of that fact.[2] Whether it is necessary to allege the *recovery of a judgment against the corporation*, depends upon the consideration of principles already stated. The general rule is, that the allegation of facts which are tantamount to a *dissolution* of the corporation, and which show that a judgment against the corporation would be useless and unavailing, excuses the recovery of a judgment against the corporation, since the law does not always require a suitor to do a vain thing.[3] Accordingly, it has been held, in an action by creditors to enforce the statutory liability of stockholders for debts contracted by a corporation, where it is alleged that the company is insolvent, that it has entirely ceased to do business, and that it has made an assignment for the benefit of creditors, having neither money, credit, nor materials with which to transact business, that it is not necessary further to allege that the plaintiff had recov-

[1] *Ante*, § 3521. A *complaint* in the nature of a creditor's bill, by a judgment creditor of a corporation against the assignee, for the benefit of creditors of a stockholder, which sets out judgments in favor of plaintiff recovered against the corporation while the subscriptions of defendant's assignor were unpaid, and alleges that executions were issued thereon and returned *nulla bona*, sufficiently shows an indebtedness of the corporation to plaintiff to entitle him to maintain his action against defendant. Samainego *v.* Stiles (Ariz.), 20 Pac. Rep. 507.

[2] *Ante*, § 3363.

[3] *Ante*, §§ 3345, 3371.

ered a judgment against the corporation upon which an execution had been returned unsatisfied.[1]

§ 3632. **Averment of Insolvency or Dissolution.** — It is not necessary to aver that the corporation is *insolvent,* except in those cases where the charter makes the liability depend upon this fact, or requires the creditor to first exhaust his remedy against the corporation.[2] And where the right to proceed against the stockholder depended upon the fact of the company being *dissolved,* a *general averment* of *insolvency or dissolution* was held sufficient.[3] The facts and circumstances constituting the dissolution are *matters of evidence,* and need not be set forth in the declaration or complaint; therefore a general averment of the fact of dissolution is sufficient to admit evidence of that species of *de facto* dissolution,[4] which lets in the remedies of the creditor against the stockholder.[5] It has been held that it is not bad pleading for the plaintiff to allege in a single count the recovery of the judgment and the return of the execution *nulla bona* against the corporation in 1840, and that afterwards, to wit, in 1843, the corporation was dissolved. There was no *repugnancy* in such allegations, since the corporation might well have been *in esse,* though insolvent, in 1840, and might have become dissolved in 1843. The objection to the pleading would have been a good one if put on the ground of *duplicity,* rather than *repugnancy;* but at all events the rule would apply that if the matter unnecessa-

[1] Morgan *v.* Lewis, 46 Ohio St. 1; *s. c.* 21 Am. & Eng. Corp. Cas. 605; 17 N. E. Rep. 558; 4 Rail. & Corp. L. J. 113.

[2] Perkins *v.* Church, 31 Barb. (N. Y.) 84.

[3] Perry *v.* Turner, 55 Mo. 418. *Contra,* Robertson *v.* Sibley, 10 Minn. 323, where the action was by a *sheriff,* as levying officer, and where the proceeding seems to have been tantamount to a garnishment, and there was no averment of a *call.*

[4] *Ante,* § 3345.

[5] Gibbs *v.* Davis, 27 Fla. 531; *s. c.* 8 South. Rep. 633. In this case, the allegation which was held sufficient was that "this company had been dissolved." The court cited Overmeyer *v.* Cannon, 82 Ind. 458, and Bank of Poughkeepsie *v.* Ibbotson, 24 Wend. (N. Y.) 473, 479. In this last case the averment which was held good was that "the said corporation was dissolved in fact," the last two words being surplusage.

rily stated be wholly foreign and impertinent to the cause, so that no allegation whatever on the subject was necessary, it will be rejected as *surplusage*, and it need not be proved; nor will it vitiate, it being a maxim that *utile per inutile non vitiatur;* except when, by this unnecessary allegation, the plaintiff shows that he has no cause of action.[1] And again, though the superfluous allegation be repugnant to what was before alleged, it is void, and will be rejected, and whatever is redundant and which need not have been put into the sentence, and contradicts what was before alleged, will not, in general, vitiate the pleading.[2] The count above stated averred both judgment and execution and dissolution of the corporation, either of which would, of itself, independent of the other, constitute, under the New York law, a sufficient ground of action against the shareholder; and such a pleading would seem to be obnoxious to the rule requiring the pleading to be single, the reason of which is, that it would be unnecessary and vexatious to put the opposite party to litigate and prove two points when one would be sufficient to establish the matter in issue.[3]

§ 3633. Averment of the Amount of Stock Held by Defendant. — So, where the charter of a corporation provided that in case of non-compliance with a certain section each stockholder should be personally liable to creditors to the extent of the amount of his stock, it was held that a declaration which contained no averment of the *amount of his stock* was bad.[4]

§ 3634. Averment of the Power of the Corporation to Issue the Shares. — It has been held, in a case where the action was brought seemingly by the assignee of the share subscriptions of a corporation, that it is necessary for the plaintiff to aver facts showing the power of the assignor corporation to have a capital stock and to take subscriptions

[1] 1 Chitty Pl. (2 Am. ed.) 231.

[2] *Ibid.* 232.

[3] Freeland *v.* McCullough, 1 Denio (N. Y.), 414; *s. c.* 43 Am. Dec. 685, 693.

[4] Sherman *v.* Smith, 20 Ill. 350.

therefor; since this is not a matter of legal presumption, there being many corporations that have no capital stock. A complaint omitting such an averment fails to show that the alleged subscription was of any avail, either as giving the subscriber a right of action against the company, or as furnishing any consideration for his alleged promise to pay for the shares, or as showing that the company was in any way bound or able to let him have them.[1]

§ 3635. Allegation that the Shares are Assessable.— Where the purpose of the creditor is to charge the shareholder in respect of what is unpaid on his shares, he must, of course, allege that the shares are assessable, or that something is due from him to the corporation in respect of them: otherwise his petition states no cause of action.[2]

§ 3636. Not Necessary to Aver Want of Knowledge that the Shares were not Paid for.—In a general creditors' suit in equity to charge the stockholders on the theory of not having paid for their shares, it is not necessary for the complainant to allege that he extended credit to the company in ignorance of that fact, or in ignorance of the manner in which the shares had been paid up where they were paid for in specific property at a certain valuation, but knowledge of such facts on the part of the creditor is a matter of defense, to be pleaded by way of answer.[3] Where, in a general creditors' suit in equity,[4] a creditor, by leave of court, filed a supplemental complaint on behalf of all the creditors against the holders of the common stock of the insolvent corporation, to compel them to pay to the receiver the face value of this com-

[1] Minneapolis Harvester Works *v.* Libby, 24 Minn. 327.

[2] Blanke *v.* St. Louis-Sonora Gold &c. Mining Co., 35 Mo. App. 186; Weber *v.* Fickey, 47 Md. 196.

[3] Northwestern Mut. Life Ins. Co. *v.* Cotton Exchange &c. Co., 46 Fed. Rep. 22. Note specially this case for a bill by a judgment creditor of a corporation to charge shareholders on the ground of a *fraudulent over-valuation* of property conveyed by them to the corporation in *payment of shares*, the allegations of which were held sufficient.

[4] Under the Minn. Gen. Stats. of 1878, ch. 76.

mon stock, claiming that it had been issued without any payment whatever to the corporation for it, but that it had been given away by the corporation under the name of "bonus stock,"—the question arose whether it was necessary for the creditor affirmatively to allege that, at the time which he gave credit to the corporation, he believed that the bonus stock had been paid for, and that it represented so much actual capital, and that he gave credit to the corporation on the faith of it. In support of the contention that the creditor should be required to make this allegation, it was argued that, while there might be a presumption to that effect in the case of a subsequent creditor, yet it was a mere presumption of fact, and that in pleadings no presumptions of fact are indulged in. The court overruled this contention. "This position," said Mitchell, J., "is very plausible, and at first sight would seem to have much force; but we think it is unsound. Certainly any such rule of pleading or proof would work very inequitably in practice. Inasmuch as the capital of a corporation is the basis of its credit, its financial standing and reputation in the community has its source in, and is founded upon, the amount of its professed and supposed capital, and every one who deals with it does so upon the faith of that standing and reputation, although, as a matter of fact, he may have no personal knowledge of the amount of its professed capital, and in a majority of cases knows nothing about the shares of stock held by any particular stockholder, or, if so, what was paid for them. Hence, in a suit by such creditor against the holders of 'bonus' stock, he could not truthfully allege, and could not affirmatively prove, that he believed that the defendants' stock had been paid for, and that he gave the corporation credit on the faith of it, although, as a matter of fact, he actually gave the credit on the faith of the financial standing of the corporation, which was based upon its apparent and professed amount of capital. The misrepresentation as to the amount of capital would operate as a fraud on such a creditor as fully and effectually as if he had personal knowledge of the existence of the defendants' stock, and believed it to have been

paid for when he gave the credit. For this reason, among others, we think that all that it is necessary to allege or prove in that regard is that the plaintiff is a subsequent creditor; and that, if the fact was that he dealt with the corporation with knowledge of the arrangement by which the 'bonus' stock was issued, this is a matter of defense."[1]

§ **3637. Averment of a Call.**—Whether an averment of the call is necessary depends on principles already considered.[2] If the proceeding is by *garnishment*, a call is necessary, unless, by the terms of the contract of subscription, the whole amount, or a part of it, is presently due without a call.[3] It has been held that in an action by a sheriff under a statute[4] to recover the unpaid amount of the defendant's subscription to the stock of a corporation, which does not allege a call for any installment or any amount, but avers that no call has been made, and does not aver any default, except that "the defendant has not paid to exceed five per cent of the amount of stock subscribed for by him," is not sufficient when the charter provides that "the directors may require and receive payment to the subscriptions to the capital stock at such time and in such proportion, not exceeding ten per cent at any one installment, as they shall see fit, and may declare said stock forfeited, etc., on a failure to make payment as required, provided they shall first give thirty days' notice of such requisition."[5]

§ **3638. The Same in Statutory Action by Sheriff in Lieu of Garnishment.**—In a case in Minnesota, in what seems to have been a statutory action by a sheriff having in his hands an unsatisfied execution, against a corporation, which action seems to have taken the place of a *garnishment*, and

[1] Hospes *v.* Northwestern Man. &c. Co., 48 Minn. 174, 198; *s. c.* 31 Am. St. Rep. 637; 50 N. W. Rep. 1117; citing Gogebic Investment Co. *v.* Iron Chief Mining Co., 78 Wis. 427; *s. c.* 23 Am. St. Rep. 417; 47 N. W. Rep. 726; and distinguishing Fogg *v.* Blair, 139 U. S. 118, on the ground that the court was there dealing with a prior creditor.

[2] *Ante*, § 1830.

[3] *Ante*, §§ 3578, 3579.

[4] Pub. Stats. Minn., § 156.

[5] Robertson *v.* Sibley, 10 Minn. 323.

the obligation assumed by the subscribers to the stock of the company was to pay in installments not exceeding ten per cent each upon thirty days' notice, it was held that the complaint must *allege a call and a default* in the payment of the same, and that it did not excuse these allegations by alleging that the company was insolvent, and had totally abandoned the work for which it was created.[1] The decision follows the analogy of the rule in case of proceedings by *garnishment*,[2] and is contrary to the rule which dispenses with a call by the directors when the company has abandoned its functions by reason of insolvency.

§ 3639. Not Necessary to Aver Issue and Delivery of Certificate.—On principles already stated,[3] it is not necessary, either for the corporation or for its assignee, and by parity of reasoning for its creditor, when suing to charge a stockholder, to aver that a certificate representing the shares for which he subscribed was issued and delivered to him by the corporation.[4] The reason is that the obligation to issue and deliver the certificate is generally regarded as concurrent with the obligation to make full payment therefor.[5] It follows, as a general rule, that the failure of the corporation to deliver or tender the certificate is *not even matter of defense in such actions.*[6]

§ 3640. Not Necessary to Aver that All the Stock was not Subscribed.—We have seen that a subscription to the capital stock of a corporation is not enforceable until all the stock provided for in the articles of association or other contract of subscription has been subscribed.[7] In an action where it is sought to charge the stockholder in respect of unpaid stock,

[1] Robertson *v.* Sibley, 10 Minn. 323.

[2] *Ante*, § 3578.

[3] *Ante*, §§ 1140, 1962.

[4] Minneapolis Harvester Works *v.* Libby, 24 Minn. 327; St. Paul &c. R. Co. *v.* Robbins, 23 Minn. 439; Marson *v.* Deither, 49 Minn. 423; *s. c.* 52 N. W. Rep. 38.

[5] *Ibid.*

[6] Columbia Electric Co. *v.* Dixon, 46 Minn. 463, 466; *s. c.* 44 N. W. Rep. 244; *ante*, § 1962.

[7] *Ante*, § 1235.

the fact that all the stock so provided for was not subscribed, is *matter of defense*, and must be pleaded as such, unless it appears on the face of the complaint.[1]

§ 3641. Not Necessary to Aver how the Defendant Became a Stockholder. — It is not necessary, in suing one or more stockholders, to aver how or in what manner the defendant or defendants became stockholders; since that is matter of *evidence*, and if the fact is denied, it must be proved by the plaintiff by competent evidence.[2]

§ 3642. Sufficiency of Averment in Actions by Receiver against Individual Shareholders. — In an action by the receiver of a national bank against a shareholder to recover an assessment ordered by the Comptroller, an allegation in the petitition that on a day named "the Comptroller of the Currency, in order to pay the liabilities of" the bank, "made an assessment upon all the said shares of the capital stock of said" bank of one hundred per cent upon its par value, "and ordered the stockholders to pay the same on or before" a day named, was held sufficient to show that the requisite action was had by the Comptroller, not only as to determining upon the necessity of an assessment, but also as to the enforcement thereof by suit against the delinquent stockholders.[3] In such an action, an allegation "that by virtue of the premises, and of the statutes in such case made and provided, the defendant became and is indebted to your petitioner in the sum of," etc., sufficiently showed that defendant had become indebted in the sum named, and also that such indebtedness still continued when the petition was filed, and was equivalent to an allegation of non-payment.[4]

[1] Tabor *v.* Goss &c. Man. Co., 11 Col. 419; *s. c.* 21 Am. & Eng. Corp. Cas. 650; 18 Pac. Rep. 537.

[2] Overmeyer *v.* Cannon, 82 Ind. 457.

[3] Welles *v.* Stout, 38 Fed. Rep. 67. That such action on the part of the Comptroller is an indispensable prerequisite to the institution of suits by the receiver, see Kennedy *v.* Gibson, 8 Wall. (U. S.) 498.

[4] Welles *v.* Stout, 38 Fed. Rep. 67.

§ 3643. When not Necessary to Declare against the Stockholders as Partners. — To charge stockholders with an individual liability, it is not necessary to declare against them as *partners*,[1] except in those cases where the action proceeds on the ground that there has never been a corporation, or that the governing statute has not been complied with in such a manner as to clothe the coadventurers with immunity from the general liability of partners.[2]

§ 3644. The Prayer for Relief. — The general rule is, that a plaintiff will not be thrown out of court, if he exhibits a state of facts which entitles him to affirmative relief against the defendant, merely because he demands an inappropriate kind of relief, provided his complaint contains a prayer for *general relief*.[3] In such a case it has been said that "if the allegations of the petition entitle the plaintiff to *any* measure of redress, a deaf ear will not be turned to his complaint simply because *he thinks* that justice should be dispensed to him in a particular way, other than and different from that to which he is actually entitled."[4] Accordingly, in an action against a corporation to collect and convert its assets and apportion them among creditors under the Minnesota statute,[5] the individual liability of stockholders for the corporate debts may be enforced upon the application of any creditor who is a party to the proceedings, although the complaint of the judgment creditor who instituted the action did not demand any such relief.[6]

§ 3645. Common-law Action Brought by Stockholder in Name of Corporation. — We have already had occasion to note a rule of pleading at common law, under which an action against a stockholder, brought by the receiver, assignee, or

[1] Holt *v.* Blake, 47 Me. 62.

[2] *Ante*, § 2969. Under some theories, they are not even then suable as partners: *Ante*, § 2992.

[3] Pomeroy *v.* Benton, 57 Mo. 531; Snider *v.* Coleman, 72 Mo. 568.

[4] Biddle *v.* Ramsey, 52 Mo. 153, 158; Bevin *v.* Powell, 11 Mo. App. 216, 223.

[5] Gen. Stat. Minn., ch. 76.

[6] Arthur *v.* Willius, 44 Minn. 409; *s. c.* 46 N. W. Rep. 851.

other representative who sues in right of the corporation, is brought in the name of the corporation to *the use of such assignee*, receiver, etc.[1] In Pennsylvania, where an action at law is given to the creditor of the corporation directly against any stockholder,[2] the same rule of pleading is in vogue.[3]

Article II. Questions of Evidence.

Section
3650. Questions of fact in actions to charge stockholders.
3651. Necessity of proving existence of the corporation.
3652. Manner of proving the existence of the corporation.
3653. Evidentiary effect of certificate of organization.
3654. Certificate of corporate officer that capital has been paid in.
3655. Effect of failing to prove that the defendant is a stockholder.
3656. Manner of proving this fact.
3657. Corporate records as evidence against the stockholder.

Section
3658. Further of this subject.
3659. Continued.
3660. What judicial records admissible, and what not.
3661. Evidence to establish the debt.
3662. Declarations made by the defendant to other creditors.
3663. Evidence to charge the members on ground of fraud.
3664. Evidence of the insolvency of other stockholders.
3665. Evidence of fraudulent over-valuation of property transferred in payment of shares.

§ 3650. Questions of Fact in Actions to Charge Stockholders.—In an action to charge a person as a stockholder for the debts of the corporation, the question whether he has subscribed to its capital stock, or has otherwise become a stockholder in it, is, of course, a question of fact for the chancellor or for the jury, accordingly as the action is in equity or at law.[4] In Pennsylvania, where a doctrine obtains applicable to actions at law, by creditors of certain corporations, to collect from the stockholders an indebtedness of the corporation to the extent of what is unpaid on their shares, that if all the

[1] *Ante*, § 3570.

[2] The cases of this kind which the writer has observed were in respect of *moneyed corporations:* whether the rule applies to all corporations in that State the writer does not know.

[3] See, for a precedent, Citizens' &c. Bank *v.* Gillespie, **115 Pa. St. 564**; *s. c.* 9 Atl. Rep. 73.

[4] Central **Agricultural** Asso. *v.* Alabama Gold Life Ins. Co., 70 Ala. 120, 135; *s. c.* 9 **Am. & Eng.** Corp. Cas. 8, 15.

unpaid subscriptions are required to pay the creditors, no assessment is necessary to support the action,[1] the question whether the whole of the unpaid subscriptions of the stockholders is necessary to pay the debts of the corporation is a question of fact for the jury; and where no assessment is proved, unless the jury find this fact affirmatively, there can be no recovery.[2] The conclusive effect of the decision of these questions of fact, on a review by *appeal* or *writ of error*, depends upon the theories of appellate procedure which obtain in the particular jurisdiction. In Alabama the decision of the *chancellor* on such a question is not disturbed on *appeal* unless there is a decided preponderance of evidence against it.[3]

§ 3651. Necessity of Proving Existence of the Corporation.—It has been held in Maine, in an action at law under a statute to charge a stockholder, that the existence and organization of the corporation must be proved by *direct evidence*, and that the judgment obtained by the plaintiff against the company is not conclusive evidence of the existence and organization of the company as a corporation in such an action[4] In like manner, in Pennsylvania, in an action at law against several parties alleged to have been directors and officers of a chartered bank, to recover upon bills issued by them which had become worthless, it is incumbent upon the plaintiff to *prove the charter*,—which in this instance consisted of letters patent signed by the Governor,—where, under the act of incorporation, a charter was necessary to create the bank a body corporate.[5] In Massachusetts, in an action against an alleged manufacturing corporation, seeking also to charge the stockholders who are summoned in the suit in pursuance to a statute,[6] it is incumbent on the plaintiff to prove the existence of the corporation in order to

[1] Yeager *v.* Scranton Trust Co. (Pa.); 14 Week. Not. Cas. 296; Citizens' &c. Bank *v.* Gillespie, 115 Pa. St. 564, 572; *s. c.* 9 Atl. Rep. 73.

[2] Citizens' &c. Bank *v.* Gillespie, 115 Pa. St. 564; *s. c.* 9 Atl. Rep. 73.

[3] Central Agricultural &c. Asso. *v.* Alabama Gold Life Ins. Co., *supra.*

[4] Hudson *v.* Carman, 41 Me. 84.

[5] Gardner *v.* Post, 43 Pa. St. 19

[6] Mass. Stat. 1851, ch. 315.

charge the stockholders, although the corporation has suffered a *judgment by default.*[1] The governing principle is, that the stockholder has a right to a hearing or adjudication of the question whether he is a member of such a corporation as that in which he is impleaded, and as such liable for its debts. "It is obvious that the trial of the issue which is thus opened to an alleged stockholder necessarily involves the question of the legal existence of the corporation for the debt of which he is sought to be charged, because his liability depends upon the nature of the corporate body and of the powers and duties with which it was clothed by law. Until these are shown it cannot be known whether the stockholder is legally chargeable or not."[2]

§ **3652. Manner of Proving the Existence of the Corporation.**—The manner of proving the existence of the corporation has already been considered in several relations.[3] Where a corporation is alleged to exist *under a special charter*, it is not enough merely to prove the granting of the charter, but it must also be proved that it was *accepted* by the grantees named therein. What will be evidence of such acceptance has already been considered.[4] In all cases proof ought to be made by the production of the *best evidence* which the case admits of. Thus, it has been held that regularly the acceptance of a charter is to be proved by producing the books of the corporation,—these being the regular and proper evidence of its doings under its charter.[5] If the corporation is organized under a statute which requires the associates to enter into articles of association, the regular evidence of corporate existence is the production of these articles, or of an exemplification of them from the public record where they are required to be recorded. Thus, in Massachusetts, where the statute requires, in order to form a corporation of a given kind, that not less than three persons must enter into

[1] Utley *v.* Union Tool Co., 11 Gray (Mass.), 139.

[2] Utley *v.* Union Tool Co., *supra.*

[3] *Ante,* §§ 60, *et seq.,* 248, 249, 1846, *et seq.*

[4] *Ante,* § 60, *et seq.*

[5] Hudson *v.* Carman, 41 Me. 84.

"articles of agreement in writing,"[1] it was held that persons impleaded with the corporation as stockholders under another statute,[2] for the purpose of charging them with its debt, could not be so charged without the plaintiff proving the existence of the corporation by making proof of articles of association in writing, fixing the amount of the capital stock, and describing the purpose of the incorporation.[3] Where the company has been incorporated by a special act of the Legislature, it is, in general, sufficient to give in evidence the statute, and to show the actual use of the privileges of an incorporated company under the name designated in the act, to entitle one to maintain an action against the corporation.[4] The acceptance of a particular statute or charter by a corporation may be proved by acts of its officers from which such acceptance is to be inferred; it is not indispensable to show a written instrument or vote of acceptance on the corporate books.[5] In a suit by a creditor of an alleged corporation to charge the defendant as a stockholder, evidence that the defendant was present at the organization of the company as a corporation, was elected and acted as president, and signed the note in suit as such, was held *prima facie* proof of the existence and organization of the corporation, and of the defendant's relation as a stockholder, the absence of other evidence being accounted for.[6] The existence of the corporation may be proved by producing the books of the company containing the *license* issued to the corporation by an officer of the State, under a statute, to enable it to act as such.[7] It may also be proved by a certified copy of the *notice* of the formation of the corporation, made in pursuance

[1] Mass. Stat. 1851, ch. 133.

[2] Mass. Stat. 1851, ch. 315.

[3] Utley *v.* Union Tool Co., 11 Gray (Mass.), 139.

[4] Narragansett Bank *v.* Atlantic Silk Co., 3 Met. (Mass.) 282; Came *v.* Brigham, 39 Me. 35; Merchants' Bank *v.* Harrison, 39 Mo. 433; *s. c.* 93 Am. Dec. 285; Haynes *v.* Brown, 36 N. H. 545. See Ang. & Ames on Corp., § 635.

[5] Palfrey *v.* Paulding, 7 La. Ann. 363, 365; Bank of United States *v.* Dandridge, 12 Wheat. (U. S.) 71; Gorman *v.* Pacific R. Co., 26 Mo. 441, 453; *s. c.* 72 Am. Dec. 220.

[6] Haynes *v.* Brown, 36 N. H. 545.

[7] Culver *v.* Third Nat. Bank, 64 Ill. 528.

of the statute, sworn to by its president, treasurer, clerk, and directors, and recorded, as provided by the statute, in the registry of deeds.[1] Evidence of such a recorded certificate signed by the defendants, together with the fact that the association engaged in business in its corporate name, contracted debts, and filed other certificates required by law, which certificates were also signed by the defendants, declaring the corporate character of the association, is conclusive of such fact in a proceeding to enforce the statutory liability of the defendants as its officers.[2] We have already seen, when considering this question in other relations,[3] that it is sometimes sufficient to prove the existence of the corporation by proving a state of facts which *estop* the stockholder from denying it. Upon this principle it has been well reasoned that in an action *by an insolvent corporation* to collect an assessment for the purpose of paying their debts, the interests of the creditors will be so far regarded that no defense grounded on defects in the organization of the corporation can be maintained, unless it could have been successfully set up in answer to a creditor's bill against the stockholders to enforce their personal liability.[4] It is not perceived why the same principle should not apply in any other action where it is sought to charge stockholders in favor of creditors. It may be added that a *verbal variance* between the *name* of the corporation, as described in the declaration or other affirmative pleading, and its name as described in the articles of association, will be disregarded, unless the variance is so great as to defeat the presumption of identity of person which springs from identity of name.[5]

[1] Chamberlin *v.* Huguenot Co., 118 Mass. 532.

[2] Priest *v.* Essex Hat Co., 115 Mass. 380. Especially so, after notice to the defendants to produce their book of records, and their failure to do so. Dooley *v.* Cheshire Glass Co., 15 Gray (Mass.), 494.

[3] See, especially, *ante*, § 1862; but see, also, *ante*, § 1872.

[4] Ossipee Man. Co. *v.* Canney, 54 N. H. 295.

[5] See, for illustration, Turnbull *v.* Payson, 95 U. S. 418. See, also, on the subject of variance in the name of corporations, *ante*, § 291, *et seq.*; Priest *v.* Glenn, 51 Fed. Rep. 400.

§ 3653. Evidentiary Effect of Certificate of Organization. In jurisdictions where corporations are organized under general laws, the instrument by which the corporation is called into existence is often called a certificate of organization. This instrument is the work of the coadventurers, and it is presented to a court of justice, to the Secretary of State, or to some other official clothed by the statute with authority to issue the certificate or warrant of incorporation.[1] This certificate, or these articles of association, sustain a close analogy to what is called the "deed of settlement," in respect of joint-stock companies in England. In an action to charge a stockholder, it is, under one theory, the only admissible proof of the existence of the corporation;[2] under another, it is *prima facie* evidence against him, as, for instance, to show that his shares have been only in part *paid for*,[3] and this on the obvious principle that a written instrument is evidence against the parties to it. But upon no known principle can such a certificate be regarded as conclusive upon creditors. They may impeach it by showing that its recitals are essentially untrue, and that, notwithstanding those recitals, a portion of the stock was not paid for according to law.[4]

§ 3654. Certificate of Corporate Officer that Capital has been Paid in. — We have already noticed that, under certain statutes, the exemption of the stockholders from general liability for the debts of the corporation attaches when the officers make and deposit in some public office a certificate to the effect that the capital stock has been fixed and paid in.[5] On the principle just stated, this certificate is impeachable by the creditors of the corporation, unless the statute makes it conclusive;[6] since it is impossible to understand any principle on which a body of adventurers can take to themselves the immunities of corporators by placing a false declaration on

[1] *Ante*, §§ 219, 220.

[2] Utley *v.* Union Tool Co., 11 Gray (Mass.), 139.

[3] Grindle *v.* Stone, 78 Me. 176; *s. c.* 3 Atl. Rep. 183.

[4] Paterson *v.* Arnold, 45 Pa. St. 410.

[5] *Ante*, § 247.

[6] That a certificate of the fact by a *public* officer is conclusive, see *ante*, § 148.

the public records that they have complied with the requirements of the statute. We find, however, a decision in Massachusetts to the effect that the certificate of the officer of the corporation, stating the amount of the capital fixed and paid in, sworn to and recorded within the time prescribed in the registry of deeds, is *conclusive evidence for the stockholders*, of the facts therein stated, so as to exempt them for the subsequent debts of the company.[1] Although respect must in general be paid to the opinions of a court written by Chief Justice Shaw, this decision deserves to be characterized as proceeding upon conceptions better known to the manipulators of corporations than to lawyers and judges. It nakedly holds that whenever such manipulators, being directors of a corporation, make and file a certificate that its capital stock is paid in, that makes it paid in, even as against its creditors, although in fact it may not have been paid in, and although its creditors may have been deceived and defrauded into giving it credit by its false recitals. Chief Justice Shaw builds up an argument that to hold it otherwise than conclusive in favor of stockholders might be ruinous to their private fortunes. How? Ruinous by reason of their being required to pay debts contracted by their own trustees, elected by them to carry on a business in which they have invested their money, and out of which they expect to derive a profit. In other words, they are to be ruined by being required to pay their own debts, and by being required to make good representations which their own agents have made to the public. The decision is a monstrous one. Not one word can be said in its favor. If the case had been one of a subsequent purchaser, who had bought the shares on the faith of the representation in the certificate thus made and filed, that they were fully paid up, then the case would be different;[2] but such does not appear to have been the case, nor was the decision put upon that ground.[3] Such a case is to be distinguished from

[1] Stedman *v.* Eveleth, 6 Met. (Mass.) 114.

[2] *Ante*, § 1680, *et seq.*

[3] Chief Justice Shaw says (at page 121): "The individual stockholders may have come in by purchase, by

cases previously considered, which hold that a *certificate* of incorporation issued by a *public official*, in pursuance of statute, is conclusive; because the issuing of such a certificate, after examination, is a *quasi adjudication* of the facts therein stated.[1]

§ 3655. Effect of Failing to Prove that the Defendant is a Stockholder.—In such proceedings, proof must be made of the fact that the person is a stockholder; and if the court, in the absence of such proof, proceed to judgment, the *judgment* will, it has been held in an isolated case, be *void.* The reason is: "If evidence is offered to establish the fact, and the court passing upon it decide the question, the decision, though erroneous, will not render the subsequent judgment void, but only voidable, and the judgment will be conclusive, until set aside or reversed by the court which granted it, or by some other court having appellate jurisdiction. But if, on the contrary, no proof whatever is offered of the fact, and it is not ascertained, as provided by the act, the court, in proceeding to render judgment, undertakes to dispense with a condition precedent upon which alone its right to give judgment in proceedings under this act is founded, and its act will be void."[2] It is believed to be sufficient for the purposes of practical justice to say that such a judgment, rendered without any evidence that the defendant is a stockholder, will be *erroneous;* since the *record proper* will not show that the court proceeded without evidence—that would require a *bill of exceptions;* and this will never be presumed where the record is silent and the court is a superior court of record. The fact that there is no evidence to the effect could never be shown

succession, or operation of law, long after such certificate was filed; and yet, if such certificate is not conclusive,—a certificate made pursuant to law, by persons over whom they had no control, between whom and themselves no relation subsisted when it was made,—they would be rendered liable for large amounts of debts, upon proof of facts of which they could have no knowledge." But it nowhere appears that the stockholder in question did come in by purchase, succession, or otherwise.

[1] *Ante*, §§ 249, 2991.

[2] Diven *v.* Lee, 36 N. Y. 302; citing Gallatian *v.* Cunningham, 8 Cow. (N. Y.) 361, 370.

by matter of record, unless there was a bill of exceptions purporting to recite all the evidence, and this is never taken except as a preparation for a review of the judgment in a direct proceeding by writ of error or appeal. Nor has the writer ever met with a decision in which it was held in a collateral proceeding that a judgment was void or valid by reason of what appeared or failed to appear in a bill of exceptions.

§ **3656. Manner of Proving This Fact.**—This subject has received an extensive consideration in a previous title,[1] and it may be added, in connection with what has immediately preceded, that the evidence to show that the defendant is a stockholder need not consist of a *writing*. As already seen, he may subject himself to the liabilities of a stockholder by his *conduct*.[2] Upon this principle it has been held that evidence showing that the defendant gave a *proxy* to another to vote at the ensuing annual corporate election, the time for holding which was less than thirty days from the time when the debt was contracted, and that by the charter the stockholders could only vote upon stock which they had held for thirty days preceding the election,—was *prima facie* sufficient to show that he was a stockholder at the time *when the debt was contracted*.[3] But the liability as a stockholder for a judgment debt of a corporation is not established merely by proof that in the suit in which the judgment was recovered, the person sought to be charged as a stockholder was *summoned as a stockholder, and failed to appear*.[4] So, on a principle already stated,[5] proof that the defendant *received dividends* is well-nigh conclusive evidence of his having been a stockholder in an action to charge him as such on behalf of creditors.[6] So, of course, his *admissions of record* in the particular action may be appealed to as evidence against him; and hence where the

[1] *Ante*, § 1877, *et seq.*

[2] *Ibid.*

[3] Harger *v.* McCullough, 2 Denio (N. Y.), 119. See, also, *ante*, § 1903.

[4] Mason *v.* Cheshire Iron Works, 4 Allen (Mass.), 398.

[5] *Ante*, § 1909.

[6] Turnbull *v.* Payson, 95 U. S. 418.

main issue was whether defendant was a subscriber, and in one plea he admitted that he did subscribe to the stock of a company proved to be the same as the one in the name of which suit is brought, it was held that such admission could be used against him in the trial of other pleas.[1] So, on a principle already considered,[2] where the governing statute or scheme of incorporation requires a person, in order to be eligible to the office of *director*, to possess a given number of shares, called in England "*qualification shares,*" evidence that the defendant in the action was elected to and accepted the office of director is material, as tending to show that he was a shareholder to the extent of the number of shares required to qualify him for the office, and under some theories it is conclusive evidence.[3] Thus, it has been held that one who is elected and acts as a director of a corporation whose articles require each director to be the holder of a certain number of shares, is liable, in the event of its insolvency, to be made a contributory to the extent of that number of shares, although he never applied for them, and was never registered as a member of the company.[4]

§ 3657. Corporate Records as Evidence against the Stockholder.—This brings us to consider the question to what extent the records of the corporation can be used as evidence in these actions. And here it ought to be observed in the first place that under no sound principles can such records be put in evidence to connect a stranger with the corporation—to prove that the particular defendant is a shareholder, unless he is shown to have been privy to them by other evidence. For it cannot possibly be admitted in a system of jurisprudence that pays attention to the ordinary maxims of justice, that I can make a stranger my debtor by merely writing down in my books a statement to the effect that he is my debtor and

[1] Howard *v.* Glenn, 85 Ga. 238; *s. c.* 21 Am. St. Rep. 156; 11 S. E. Rep. 610.

[2] *Ante*, §§ 1260, 1261, 1896, 1897.

[3] Moore *v.* Boyd, 74 Cal. 167; *s. c.* 15 Pac. Rep. 670.

[4] Isaacs's case [1892], 2 Ch. 158, C. A.

by signing his name to it. But as some courts, on a supposed principle of necessity, admit the books of a plaintiff as *prima facie* evidence of his *account* against a defendant sought to be charged in an action on an account,[1] so some of the courts have fallen into the aberration of holding that the books and other records of the corporation may be given in evidence, in a proceeding to charge a stockholder, *for the purpose of proving that he is a stockholder*,[2]—which fact ought to be first proved by evidence *aliunde*, in order to lay a foundation for the introduction of the books and records in evidence against his objection.[3] But although the corporate records may not be admissible to connect a stranger with the corporation, they are clearly admissible for the purpose of proving the organization and existence of the corporation itself.[4]

§ **3658. Further of This Subject.**—It has been held, on the most obvious grounds, that the resolutions adopted and declarations made at a corporate meeting are not evidence of the truth of matters recited or declared, as against persons who were not members of the corporation at the time.[5] By parity of reasoning it would be necessary to prove that a stockholder was a member of the corporation at the time of the passage of such resolutions, or the making of such declarations, in order to make them admissible in evidence against him; and it is difficult to understand how this could be proved by the resolutions themselves, any more than the authority of an agent can be proved by his own declarations, where

[1] See a learned note on this subject, 15 Am. Dec. 191, *et seq.*

[2] Turnbull *v.* Payson, 95 U. S. 418, 421; Liggett *v.* Glenn (Cir. Ct. App.), 51 Fed. Rep. 381, 393; affirming on this point, *s. c.* 47 Fed. Rep. 472; Glenn *v.* Orr, 96 N. C. 413; Vanderwerken *v.* Glenn, 85 Va. 9, 14; Semple *v.* Glenn, 91 Ala. 245; *s. c.* 24 Am. St. Rep. 894; 9 S. W. Rep. 265; Lehman *v.* Glenn, 87 Ala. 618; Weber *v.* Fickey, 52 Md. 500.

[3] Neilson *v.* Crawford, 52 Cal. 248; Howard *v.* Glenn, 85 Ga. 238, 263; *s. c.* 21 Am. St. Rep. 156; 11 S. E. Rep. 610.

[4] Hudson *v.* Carman, 41 Me. 84; Coffin *v.* Collins, 17 Me. 440; Glenn *v.* Orr, 96 N. C. 413; Semple *v.* Glenn, 91 Ala. 245; 24 *s. c.* Am. St. Rep. 894; 9 S. W. Rep. 265.

[5] Redding *v.* Godwin, 44 Minn. 355; *s. c.* 46 N. W. Rep. 563.

there are no elements of estoppel as against his principal. The rule declared by so many cases in the preceding section is, by the confession of the judges who have adopted and followed it, difficult to defend on principle. In one case it was put upon the principle that such evidence is received and acted upon by the business community.[1] But a moment's reflection will serve to convince one that a generalization of this principle would make wide inroads into existing rules of evidence. Business men constantly act upon *hearsay evidence*, and upon the declarations of third parties not under oath, even where they are not reduced to writing. To state more particularly the manner in which the courts have applied this rule, we find that it has been held, in an action against an alleged stockholder in the "National Express and Transportation Company," that a contract of subscription to the stock of the "National Express Company" is admissible to prove the fact of subscription, where it appears from the records of the corporation that, in the process of its organization, there was a change from the latter to the former name, and that the defendant was entered on the stock books of the former as an owner of certain shares which he afterwards assigned.[2] We also find a concession that the stock ledger is not admissible to connect the defendant with the corporation if *better evidence* is attainable. Thus, in an action against the executors of a deceased member of a partnership firm to recover an assessment on the stock of a corporation, the complaint alleged that the firm subscribed and agreed to pay for the stock, and thereby became stockholders. The defendants specifically denied each of these allegations. Here the court held that, as the issue related to the *fact of subscription*, the best evidence of that fact was the written subscription itself, and that, until it was produced or its absence accounted for, the stock ledger was inadmissible.[3] Whether the mere fact that a name the same as that of the defendant had been entered on the stock

[1] Liggett *v.* Glenn, 51 Fed. Rep. 381, 393; opinion by Mr. District Judge Shiras.

[2] Priest *v.* Glenn, 51 Fed. Rep. 400.

[3] Taussig *v.* Glenn, 51 Fed. Rep. 409.

ledger of the corporation was sufficient, *prima facie*, to charge him, under the principle that identity of name carries a presumption of person, was mooted in some of the Glenn cases. In one of the cases the holding was, that the stock books were competent evidence to show that the defendant was a stockholder, in connection with other evidence showing that the name entered therein, which was identical with the defendant's name, was entered as his name.[1] In one of the Glenn cases the Supreme Court of Georgia, following what we conceive to be the sound principle, held that, while the books of the corporation were not admissible to connect the defendant with it as a shareholder, yet that, it having been proved *aliunde* that he had subscribed for the shares, the books became admissible to show any transaction, relevant to issues, which had taken place between him and the corporation.[2] This is in accordance with the holdings of all the courts;[3] and on this theory the books would be admissible against the stockholder to show the state of his account with the corporation in respect of his holdings of shares therein. But their entries would not be conclusive — they would not even stand on the footing of *admissions* made by him without other proof of his having assented to them, because they were originally not made by the stockholder, but were made by a ministerial officer under the control of the directors. It was, therefore, held, with the most obvious propriety, that where the stock subscription list had been admitted in evidence, it was error to refuse to allow the defendant to make proof that he did not in fact subscribe thereto.[4] Even if he had made admission to that effect, that, ordinarily, would not be an estoppel, but would be subject to explanation. Other courts have gone so far as to hold that where the stock book contains a list of the stockholders, the number of shares owned by each, the sum of money paid by each, and the balance due, such book is

[1] Liggett *v.* Glenn, 51 Fed. Rep. 381; affirming on this point, *s. c.* 47 Fed. Rep. 472.

[2] Howard *v.* Glenn, 85 Ga. 238, 263; *s. c.* 21 Am. St. Rep. 156.

[3] *Post*, ch. 185, art. I.

[4] Howard *v.* Glenn, *supra*.

prima facie evidence against a stockholder, not only to show that he was a stockholder, but also to show the *condition of his account*,—that is to say, how much is still unpaid upon his share subscription.[1]

§ **3659. Continued.**—In one such case it was held that the books of the corporation were admissible, *prima facie*, to prove the correctness of the subscription alleged to have been made by the defendants, especially in view of the fact that they had interposed no *plea denying on oath* the genuineness of their original subscription, and were shown to have paid one assessment thereafter; and the court added that there was no presumption that these names had been fraudulently inserted on the corporate books by act of *forgery*.[2] But in another case it was held by the same court that the books were admissible in evidence against the alleged stockholder, although he had filed a plea denying the genuineness of his subscription on oath.[3] Upon the question of the *identity of names* as presumptive evidence of *identity of person*, it was held in the United States Circuit Court of Appeals that the name "Tanssing, Livingston & Co." was not *idem sonans* with "Taussig, Livingston & Co.;" and hence that the entry of the former name on the stock books of the corporation, in the handwriting of its treasurer, was not competent evidence that the latter firm, or any of its members, were stockholders in the corporation, there being no other evidence tending to identify the name with the firm, and there having been a lapse of twenty-five years, and the firm having dissolved twenty years before, and all its members being dead. Mr. Circuit Judge Sanborn, who delivered the opinion, reasoned upon the great danger of allowing a party to manufacture evidence against another party, and of admitting such evidence in judicial proceedings after the possibility of its being rebutted had passed

[1] Glenn *v.* Orr, 96 N. C. 413.

[2] Lehman *v.* Glenn, 87 Ala. 618, 627.

[3] Semple *v.* Glenn, 91 Ala. 245; *s. c.* 24 Am. St. Rep. 894.

away.[1] Moreover, it was held that a draft drawn by the treasurer of the corporation upon the firm of Taussig, Livingston & Co., was not admissible in evidence to prove that they had subscribed for shares in the corporation, when the draft did not correspond in date with any requisition entered in the subscription account, and there was no evidence that it had been paid by the firm of alleged stockholders, or that it had ever been called to their attention.[2] It has been held, in a suit against a stockholder to recover the amount of a judgment obtained against the corporation, that entries in the stock book, and parol evidence offered in connection therewith, were admissible for the purpose of proving that the plaintiff was the owner of shares of stock fully paid up at the time he became a creditor of the corporation, and that the defendant at that time was the owner of stock which had not been fully paid for.[3] Finally, it has been held that, in an action by the administrator of an original stockholder, against one to whom he alleged he had assigned the shares, to recover over from him the amount of assessments thereon which he, the plaintiff, had paid subsequent to the transfer, the plaintiff cannot put in evidence the *blotter* of the treasurer of the corporation, and the *stubs* of his *check book*, both of which contain entries to the effect that the defendant has paid calls on the shares. The court reasoned that the rule of Turnbull *v.* Payson[4] did not apply, and the learned judge attempted to distinguish the case, but merely succeeded in proving that the rule of that case was unsound. "The reason for the distinction," said he, "is clear when it appears, as it does from the petition in this case, that the corporation, not long after the transfer, made a general assignment in favor of its creditors; for, when a corporation is in straightened circumstances, or in danger of insolvency, stockholders sometimes make haste to dispose of their stock, and the rule recognized in Turnbull *v.* Payson does not apply."[5] But why it should not apply, if

[1] Taussig *v.* Glenn, 51 Fed. Rep. 409.

[2] *Ibid.*

[3] Weber *v.* Fickey, 52 Md. 500.

[4] 95 U. S. 418, 421.

[5] Tripp *v.* Appleman, 35 Fed. Rep. 19.

it is a sound rule, was not made to appear, for certainly the instruments of evidence offered had a direct tendency to show that the defendant had paid calls on the shares, thus having accepted the transfer.[1]

§ 3660. What Judicial Records Admissible, and What not. — Where a *receiver* is suing he may of course prove the judicial proceeding in which he was appointed as necessary proof of *his title*,[2] unless he is suing in the same court which appointed him, when it is supposed that the court would take *judicial notice* of it, and instruct the jury accordingly. In an action by a *billholder* against a stockholder in a bank, an exemplification of the record of the case of the same plaintiff against the assignee of the bank is admissible as evidence of the *identity of the bill* upon which suit is brought.[3] But, in a proceeding by motion, under a statute, by a judgment creditor of the corporation, to obtain an execution against the particular stockholder, the record of a proceeding in equity by creditors of the corporation against the corporation and some of its stockholders, to which the present plaintiff was never made a party, was *res inter alios acta* and irrelevant, and was erroneously admitted in evidence for the defendant. So, also, was the record of a judgment in favor of the defendant against the corporation, rendered long after the filing of the motion for execution against the defendant, and wherein the present plaintiff was not a party.[4]

§ 3661. Evidence to Establish the Debt. — In an action to enforce the statutory liability of a stockholder, it is plain that any evidence which would be admissible to establish the demand as against the corporation, is in general admissible to

[1] The entry on the blotter recited: "Received from A. R. Appleman, five per cent on 50 shares of $250." This entry was made under the head of "Cash to fourth assessment." A. R. Appleman was the defendant. The attempt to take the case out of the rule of Turnbull *v.* Payson was a most obvious failure.

[2] Hall *v.* United States Ins. Co., 5 Gill (Md.), 484.

[3] McDougald *v.* Lane, 18 Ga. 444.

[4] Coquard *v.* Prendergast, 35 Mo. App. 237.

establish it as against the stockholder.[1] If the action is upon a promissory note of the corporation, and the *authority* of the officers of the corporation to make the note is denied by the defending stockholder, evidence of *other notes* given by the proper officers of such company is admissible to show the authority of the officers so to contract;[2] and so, for the same reason, is evidence of the recovery of *other judgments* upon notes made by such officers.[3]

§ 3662. Declarations Made by the Defendant to Other Creditors. — It has been held, in an action of *assumpsit* against a member of a corporation, brought by one of its creditors to recover money lent to it, that evidence is not admissible to prove that the defendant *informed other creditors* when they lent money to the corporation, that its members were individually liable for its debts, and showed them a by-law of the corporation imposing such liability.[4] The reason is, that the defendant might have been mistaken as to his legal rights, and such a declaration does not hence possess the qualities of an admission.

§ 3663. Evidence to Charge the Members on Ground of Fraud. — To render the members of a corporation personally liable for its debts on account of fraud, creditors must show that they were induced to become creditors by something said or done by its members, amounting to the perpetration of a deceit upon them. Merely to show fraud in a petition upon which the act of incorporation was obtained, is not enough to enable creditors to recover, where they do not show fraudulent representations made to themselves.[5]

§ 3664. Evidence of the Insolvency of Other Stockholders.—In an action by the assignee of a corporation, to recover the amount due by a subscriber who alleged that the whole

[1] Borland *v.* Haven, 37 Fed. Rep. 394.

[2] Moss *v.* Averell, 10 N. Y. 449, 457.

[3] Moss *v.* McCullough, 7 Barb. (N. Y.) 279.

[4] Trustees *v.* Flint, 13 Met. (Mass.) 539.

[5] Sisson *v.* Mathews, 20 Ga. 848.

amount due by stockholders was not required to pay the creditors of the company, it was held error to permit the defendant to show the *financial condition of another stockholder*, without first showing the amount of his subscription.[1] Similar to this is a holding in an action by the assignee of a corporation against one of its stockholders, where there had been no previous account and ascertainment of the amount which it would be necessary to collect from each stockholder in order to liquidate the debts of the company, but where the assignee alleged in his petition that "the whole amount of said unpaid balance on said stock [meaning the stock of the single shareholder sued as defendant] is needed to pay tho debts of said corporation." It was set up in the answer that no call had been made, either by the corporation or by any court; that there were many stockholders; that the plaintiff had not brought actions against all of them; and that the amounts which each should pay toward liquidating the debts of the corporation could only be determined by a suit in equity. To support this petition and meet this defense, the assignee offered evidence of the insolvency of some of the stockholders, for the purpose of proving that the aggregate amount due from solvent stockholders was not more than sufficient to pay the debts of the corporation. This evidence was rejected by the trial court, and its ruling was affirmed on appeal. The appellate court held: 1. That where the aggregate amount due upon their shares from all the stockholders, solvent and insolvent, is not sufficient to liquidate the debts of the company, the assignee may bring an action against any shareholder, without there having been any previous assessment either by the corporation or by a court; 2. But that, where the aggregate amount due from all the shareholders, solvent and insolvent, is more than sufficient to liquidate the debts of the company, the assignee cannot, without a previous assessment being ordered by the court superintending the administration of the assigned estate, bring

[1] Citizens' &c. Sav. Bank *v.* Gillespie, 115 Pa. St. 564, 573; *s. c.* 9 Atl. Rep. 73. The court reversed the judgment for this error, because it was not easy to measure the effect of such evidence upon the jury.

actions at law against the several shareholders to recover the entire amount unpaid on their respective shares, and support his action by evidence that, if the insolvent stockholders are excluded, not enough can be collected from the solvent ones to liquidate the debts of the company. The court said: "To admit the evidence which the plaintiff offered would have changed the whole scope of the action from an action at law into a suit in equity. It would have raised a multiplicity of issues not made in the pleadings, and such as could not have been conveniently settled by the verdict of a jury, which would have required the court to withdraw the cause from a jury, if the cause had been proceeding before a jury, and send it to a referee; and the defendant might justly complain that nothing in the petition had apprised him that such was to be the nature of the proceeding."[1] It might have been added that the facts sought to be proved could be properly ascertained only in a proceeding in which all the stockholders were parties, either in person or by representation through the corporation, as in the Glenn cases;[2] and that from the very nature of the case, it could not be properly ascertained in controversies between the assignee and individual shareholders. In such controversies one jury might find the fact one way and another jury might find it another way, according to the varying evidence on the question of the insolvency of particular stockholders, which particular defendants might be able to adduce. This would inevitably lead to unequal assessments and defeat the policy of the law, which is, that the burdens of the stockholders shall be equalized if practicable.

§ 3665. Evidence of Fraudulent Over-valuation of Property Transferred in Payment of Shares. — In an action under a statute[3] to charge stockholders with debts of the corporation, on the ground that the stock had been fraudulently issued for

[1] Boeppler *v.* Menown, 17 Mo. App. 447, 455.

[2] *Ante*, §§ 3049, 3499.

[3] N. Y. Laws 1853, ch. 117; and *Ibid.*, 1870, ch. 773.

property overestimated by the trustees, the defendants claimed that the purchase was necessary for the business of the company, namely, the buying of land, and the laying out, improving, and selling of building plots. It was held that a witness for the defendants might properly testify that soon after the purchase *he offered* $4,000 for a single lot.[1] In an action to enforce the liability of a stockholder in respect of unpaid installments on his shares, where it was conceded that the shares were issued under a scheme among the promoters under which they were to be paid for to the extent of one-third of their value only, it was held that the trial court committed no error in excluding evidence to the effect that certain property turned into the corporation, as the consideration for the original issuing of the shares, was worth more than that amount.[2]

ARTICLE III. OTHER QUESTIONS OF PROCEDURE.

SECTION
3669. Questions of *res judicata.*
3670. Right of trial by jury.
3671. Reference to a master or referee.
3672. Appeals and writs of error.
3673. Conclusiveness of the finding on questions of fact where the trial is at law.
3674. Stockholders not entitled to separate trials.
3675. Filing notice of *lis pendens* to purchaser.
3676. Other points of practice.

§ 3669. Questions of Res Judicata.—An action to compel the *application of the assets* of a corporation to the payment of its debts, although brought by a stockholder and prosecuted to judgment, obviously does not bar a subsequent action to enforce the *individual liability* of a stockholder,—for the reason that the superadded individual liability of the stockholders is not assets of the corporation.[3] But it should be added, by way of caution, on the strength of what has preceded here and there in this title, that there may be systems

[1] Thurber *v.* Thompson, 21 Hun (N. Y.), 472.

[2] Boulton Carbon Co. *v.* Mills, 78 Iowa, 460; *s. c.* 43 N. W. Rep. 290; 6 Rail. & Corp. L. J. 417; 5 L. R. A. 649.

[3] Diven *v.* Duncan, 41 Barb. (N. Y.) 520.

under which the superadded individual liability is collectible by a receiver of the assets of the corporation; and then after the determination of the winding-up proceeding it may be assumed that there would be no separate right of action on the part of any creditor to enforce the superadded individual liability of any stockholder. Where the statutory system allows a single creditor to proceed, by action or by motion, against any single stockholder, if a creditor does so proceed against a particular stockholder, and subjects to the payment of his debt all that is unpaid by the stockholder in respect of his shares (and there is no superadded liability), the stockholder may obviously protect himself by pleading this in bar to another and different proceeding so authorized: he cannot be made liable over and over again to different creditors, after he has paid all that the law requires him to pay;[1] the doctrine in Missouri being that if, pending a proceeding by motion brought against a stockholder under one section of the statute, an action is brought against him by another creditor under another section, which action is prosecuted to judgment, and the judgment satisfied by the stockholder, this will be a complete defense to the former action.[2] So, also, if the creditor brings an *action* under the section of the statute granting that remedy, the stockholder may plead in bar to the action that, on a *motion* by another creditor who has obtained a judgment against the corporation, an order has been made, by the court rendering such judgment, for the issue of an *execution* against the stockholder, to the full extent of what remains unpaid on his shares.[3] This subject calls up questions relating to *priority among creditors*, which subject is reserved for a future chapter.[4] It was held in the Superior Court of New York City, on seemingly obvious grounds, that the recovery of a judgment against a stockholder, under a section of the governing statute making the stockholders jointly and severally individually liable for debts due and owing to

[1] Bittner *v.* Lee, 25 Mo. App. 559.

[2] State Savings Asso. *v.* Kellogg, 63 Mo. 540.

[3] Bittner *v.* Lee, *supra.*

[4] *Post*, § 3833, *et seq.*

the *laborers*, *servants*, and *apprentices* of the corporation, cannot be successfully pleaded as a bar to an action under another section of the same statute against the *trustees*, to charge them individually for failing to file the annual report of the condition of the corporation therein prescribed.[1]

§ 3670. Right of Trial by Jury.—Whether either party is entitled to a right of trial by jury depends upon the nature of the proceeding, and chiefly upon the question whether it is an action at law or a suit in equity. Where a single creditor brings an action at law against a single stockholder, under statutes already considered,[2] there will be a right of trial by jury, according to the law of the forum, as in other cases at law, unless a jury is waived or not demanded. On the other hand, where the proceeding is a suit in equity, or under one of the modern codes of procedure a suit of that nature, then no right of trial by jury exists under constitutional provisions guaranteeing that right in general terms; since those provisions merely guarantee the right as it existed by the common law of England, and subject to the exception that in cases falling within the peculiar jurisdiction of equity, the issues of fact were decided by the chancellor, and were not triable by jury.[3] In Missouri, where, as already seen,[4] the remedy to which a judgment creditor of a corporation most frequently resorts is a *motion* in the court in which he has recovered his judgment, *for an execution* against some stockholder, summoning the stockholder to defend the motion, there is *no trial by jury*.[5]

§ 3671. Reference to a Master or Referee.—Whether a reference to a master in chancery, the suit being in equity, will be ordered, rests in the *discretion* of the court; and the

[1] Vincent *v.* Sands, 11 Abb. Pr. (N. S.) (N. Y.) 366, 374; *s. c.* 42 How. Pr. (N. Y.) 231. Compare Sterne *v.* Herman, 42 How. Pr. (N. Y.) 376; and Richards *v.* Kinsley, 14 Daly (N. Y.), 534; *s. c.* 12 N. Y. St. Rep. 125; and 14 N. Y. St. Rep. 701.

[2] *Ante*, § 3489, *et seq.*

[3] Re Empire City Bank, 18 N. Y. 199, 210; *s. c.* Abb. Pr. (N. Y.) 192.

[4] *Ante*, § 3602, *et seq.*

[5] *Ante*, § 3613.

refusal of such reference, even where the bill is for an accounting by a corporation, its officers and stockholders, with its creditors, is not an abuse of discretion.[1] If the action is a direct action at law by a single creditor against a single stockholder, the issues will ordinarily be so simple as not to require a reference; and such a case will seldom require the taking of a "long account," which, under various codes of procedure, is made the chief condition of a reference. Again, although the case is not properly a case for a reference, objections to the order of reference must be seasonably made and exceptions saved thereto, according to the practice in the forum, in order to entitle a party to complain of it on appeal. Consenting to the reference, appearing before the referee, and filing exceptions to his report, are a waiver of the right to object to the *jurisdiction* of the court over the *person* of the defendant;[2] and for stronger reasons it would be a waiver of any right to object to the mode of trial.

§ 3672. **Appeals and Writs of Error.** — We have already had occasion to note a principle, seemingly of recent introduction, under which, in a general creditors' suit to subject the assets of the corporation, including what is due to it from its stockholders in respect of their shares, the several stockholders, resident and non-resident, are bound by the *decree making the assessment,* on the principle of being *represented as parties by the corporation.*[3] We have had occasion to note another holding to the effect that in such a suit the corporation may, and in pursuance of its duty should, in a proper case, *appeal* from an order directing the receiver to bring actions against the stockholders to collect their unpaid subscriptions; and we have also had occasion to note the effect of such an appeal.[4] In Kansas no appeal lies from an order made by a justice of the peace under the act relating to corporations, after a return

[1] Burns *v.* Beck &c. Hardware Co., 83 Ga. 471; *s. c.* 10 S. E. Rep. 121.

[2] Mason *v.* Alexander, 44 Ohio St. 318; *s. c.* 7 N. E. Rep. 435.

[3] *Ante,* §§ 3049, 3499.

[4] *Ante,* § 3514; Republic Life Ins. Co. *v.* Swigert, 135 Ill. 150; *s. c.* 25 N. E. Rep. 680.

of an execution unsatisfied, upon a judgment rendered by the justice against a corporation, awarding execution against a stockholder; it can be reviewed only by a petition in error.[1] In the courts of the United States the *verdict* of a jury in favor of the defendant that he was not a stockholder is *conclusive*, on a writ of error to the Supreme Court of the United States.[2] But in some of the State jurisdictions the rule is otherwise. Thus, in proceedings for execution against stockholders under the Missouri statute, the appellate court reviews the evidence as in a case in chancery.[3] It has been held that, where the liability of a stockholder, if established, will not subject him to a judgment for a greater sum than one dollar and forty cents, including interest, this is too trifling a matter to bring to the attention of an appellate court, but will be dismissed under the application of the maxim *de minimis non curat lex*.[4] In a suit brought by creditors of an insolvent corporation to enforce a statutory liability against stockholders, defendant A. pleaded that, prior to the insolvency of the corporation, he sold in good faith his shares of stock to B.; that B. was solvent, and a party to the action; and prayed that whatever sum might be found due in respect to such shares might be adjudged against B. Issue was joined by reply. It was held that an *appeal* taken by A. to the circuit court, from a judgment rendered in the common pleas, carried up the case as to B., whether he appealed in his own right or not.[5]

§ 3673. Conclusiveness of the Finding on Questions of Fact where the Trial is at Law. — It is well known that the Supreme Court of the United States does not review, on writ of error, the findings of juries or of courts sitting as juries, on questions of fact, at all; while in most of the State jurisdictions it is assignable for error that there was no evidence to support the verdict of the jury or the finding of the court sitting as a

[1] Healey *v.* Deepwater Clay Co., 48 Kan. 617; *s. c.* 29 Pac. Rep. 1088.

[2] Glenn *v.* Sumner, 132 U. S. 152.

[3] *Ante*, § 3614.

[4] Moore *v.* Boyd, 74 Cal. 167; *s. c.* 15 Pac. Rep. 670; citing Wolf *v.* Prosser, 73 Cal. 219.

[5] Harpold *v.* Stobart, 46 Ohio St. 397; *s. c.* 15 Am. St. Rep. 618; 21 N. E. Rep. 637; 29 Cent. L. J. 110.

jury. It follows that, in an action in the Circuit Court of the United States by a trustee in charge of the assets of an insolvent corporation, to recover from a stockholder his proportion of an assessment ordered by the court superintending the administration, a finding by the jury that the defendant never subscribed for the shares and was not liable to pay the assessment is conclusive in the defendant's favor. This being so, the question whether the court erred in a ruling upon matter also pleaded by the defendant by way of *avoidance*, such as his *discharge* in *bankruptcy*, is wholly immaterial; for, however that question might be decided, the defendant would be entitled to judgment upon the verdict.[1]

§ **3674. Stockholders not Entitled to Separate Trials.** — In Massachusetts, where several stockholders were summoned, under the provisions of a statute,[2] to answer in a suit against the corporation, and severally denied their liability, they were not entitled to separate trials by different juries.[3] But it is difficult to concur with such a holding unless it is required by the literal terms of the governing statute, and even then the statute is one not fit to be enacted. As each stockholder's liability rests on his *separate undertaking*, and as each stockholder's claim of exemption from liability may depend upon a defense peculiar to himself, it is difficult to see how a jury, or even a court or referee, could handle the question of the liability of all the stockholders in one trial. In a case where numerous stockholders have been summoned as defendants, the issues might be so numerous as to be utterly unfit for settlement in a single trial, and especially before an ordinary jury, who would be perplexed and overmastered by the multitude of details.

§ **3675. Filing Notice of Lis Pendens to Purchaser.** — A stockholder of a banking association, to whom real estate of

[1] Glenn *v.* Sumner, 132 U. S. 152, 157. The court cited Evans *v.* Pike, 118 U. S. 241; Moores *v.* National Bank, 104 U. S. 625; Morisey *v.* Bunting, 1 Dev. L. (N. C.) 3.

[2] Mass. Stat. 1851, ch. 315, § 1.

[3] Holyoke Bank *v.* Goodman Paper Man. Co., 9 Cush. (Mass.) 576, 585.

the association has been assigned to indemnify him against a precedent liability, pending a suit by a creditor of the company, and a motion for a rescission, is not a *purchaser*, within the meaning of the statute of New York, requiring a *notice* of the pendency of the suit to be filed.[1]

§ **3676. Other Points of Practice.** — If the stockholder, after being summoned, does not appear, no reason exists, growing out of the nature of his liability, why a judgment should not be taken against him *by default*, or a decree *pro confesso* entered against him, and the extent of his liability afterwards ascertained by a jury under a writ of inquiry, or by a master or referee under an order of reference, according to the nature of the proceeding and the course of the court.[2] Where the action is by a creditor against a stockholder to enforce a statutory liability, on the ground that his subscription is unpaid, the *burden of proof* is on the creditor to show that it has not been paid, although this requires him to *prove a negative*.[3] In a sequestration proceeding, under the Minnesota statute,[4] the finding of a referee that the persons proceeded against as stockholders were subscribers to the shares, and stockholders after the company commenced its operations, has been held to include a finding that every condition precedent to their becoming full stockholders, and subject to a liability as such, has been performed or waived.[5] The personal liability of a stockholder is an obligation arising *on contract*, within the statute of California,[6] giving original jurisdiction to justices of the peace of actions on contracts for the recovery of money, when the amount claimed is less than three hundred dollars.[7] There is doubtful authority for the view that an

[1] Leavitt *v.* Tylee, 1 Sandf. Ch. (N. Y.) 207.

[2] See Spooner *v.* Bay St. Louis Syndicate, 47 Minn. 464; *s. c.* 50 N. W. Rep. 601.

[3] Wellington *v.* Continental Const. & Imp. Co., 52 Hun (N. Y.), 408; *s. c.* 5 N. Y. Supp. 587; *ante*, § 3619.

[4] Gen. Stat. Minn. 1878, ch. 76, § 17.

[5] Arthur *v.* Clarke, 46 Minn. 491; *s. c.* 49 N. W. Rep. 252.

[6] Cal. Code Civ. Proc., § 112.

[7] Dennis *v.* Superior Court, 91 Cal. 548; *s. c.* 27 Pac. Rep. 103.

action may be brought against a defendant described as a certain *company*, and that a judgment may be taken against certain *individuals*, although they are not members of the alleged company, provided the jury find that they are liable individually.[1]

[1] Comanche Min. Co. *v.* Rumley, 1 Mont. 201. For a *charge to a jury* in an action involving the personal liabilities of shareholders in a joint-stock company for the debts of the company, see National Park Bank *v.* Nichols, 2 Biss. (U. S.) 146.

CHAPTER LXVIII.

DEFENSES TO ACTIONS AGAINST STOCKHOLDERS BY OR ON BEHALF OF CREDITORS.

ART. I. IN GENERAL. §§ 3679–3681.
II. DEFENSES AFFECTING THE CORPORATION AND ITS MANAGEMENT. §§ 3683–3688.
III. DEFENSES AFFECTING THE STATUS AND LIABILITY OF THE DEFENDANT AS A SHAREHOLDER. §§ 3691–3707.
IV. DEFENSES AFFECTING THE DISCHARGE AND RELEASE OF THE DEFENDANT AS A SHAREHOLDER. §§ 3711–3725.
V. DEFENSES AFFECTING THE PLAINTIFF'S DEMAND. §§ 3729–3737.
VI. DEFENSES RELATING TO THE CONDUCT OF THE CREDITOR AFFECTING HIS DEMAND. §§ 3740–3748.
VII. DEFENSES RELATING TO THE CONDUCT OF THE PROCEEDING TO CHARGE THE STOCKHOLDER. §§ 3751–3755.
VIII. OTHER DEFENSES. §§ 3758–3763.

ARTICLE I. IN GENERAL.

SECTION
3679. Scope of this chapter.
3680. General theories as to defenses which can be interposed.
3681. Defenses that the stockholders are estopped from raising.

§ 3679. Scope of This Chapter. — In this chapter it is proposed to consider a number of special defenses which have been set up by shareholders when proceeded against by creditors of the corporation, most of which have been disallowed.

It should be read in connection with the chapter in which we considered certain defenses to actions by the corporation for calls.[1]

§ 3680. General Theories as to Defenses Which can be Interposed. — Upon the general question of what defenses may be interposed by the stockholder, there are two theories which have already been considered in various places in what has preceded in this title. One of these theories is strictly applicable only in cases where the object of the creditor's action is to subject what remains unpaid by the stockholder upon his share subscription. It is that, in such cases, the creditor proceeds *in right of the corporation*, and that the stockholder is entitled to avail himself of any defense which he might have availed himself of if the corporation itself had been suing him for an assessment upon his shares.[2] This is not the general American theory, nor is it even the general theory of the court in which the case last cited was decided; but, on the other hand, the general American theory is, that there are many cases where contracts by which the corporation assumes to release a stockholder will estop the corporation, but will not be good against its creditors.[3] A contrary doctrine, and one which refers itself to a disputed question of procedure,[4] is that where a receiver, assignee, or other trustee in charge of the assets of an insolvent corporation, brings an action against a shareholder to enforce an assessment, the defendant cannot avail himself of all the defenses which would be available if the corporation, while a going concern, were suing him for an assessment, but is limited to such defenses as he might interpose against a creditor if he were suing.[5] Where the rule of the forum allows a creditor to proceed against a stockholder without first reducing his claim to a

[1] *Ante*, § 1955, *et seq.*

[2] Union Sav. Asso. *v.* Seligman, 92 Mo. 635; *s. c.* 1 Am. St. Rep. 776.

[3] But see *ante*, § 1514, and compare § 1517. It is difficult to refer, in a group, to all the sections of this work in which this doctrine is laid down, because this title is full of them.

[4] *Ante*, § 3562, *et seq.*

[5] Upton *v.* Jackson, 1 Flipp. (U. S.) 413; *s. c.* 10 Myer Fed. Dec., § 141.

judgment against the corporation, the stockholder is allowed, on an obvious principle of justice, to interpose any defense against the validity of his claim which the corporation itself might have interposed if sued thereon in the first instance.[1] With the increasing tendency of judges to subordinate the rights of *creditors* to those of the members of corporations, those creditors who became such *prior* to the issuing of the shares held by the shareholder sought to be charged, and who have not dealt with the company on the faith of any capital represented by such shares, cannot insist on the contribution by the holders of a greater amount of the capital than the corporation itself could claim from them as a part of the assets.[2] But either prior or subsequent creditors may maintain a bill against a corporation and its stockholders to compel the latter to account for stock in another corporation belonging to the former corporation, distributed among them by the corporate officers without authority from the corporation or otherwise; since the stock remains the property of the corporation, and the cause of action is one accruing in its favor.[3]

§ 3681. Defenses that the Stockholders are Estopped from Raising.—In many cases the principle of estoppel operates to cut off defenses which the stockholder might otherwise maintain. It has been well held that, after the stockholders, being cognizant of the facts, have assented to the creation, by the corporation, of an illegal debt, they cannot repudiate it on the ground that it was in excess of what the corporation was authorized to contract.[4] So, it has been held, in an action by a creditor against a stockholder, who was also *president* of the corporation, on promissory notes signed by him as such, that the defendant is estopped from denying the validity of such notes, or his own power to execute them.[5]

[1] Railroad Co. *v.* Smith, 48 Ohio St. 219; *s. c.* 31 N. E. Rep. 743.

[2] First Nat. Bank *v.* Gustin &c. Mining Co., 42 Minn. 327; *s. c.* 18 Am. St. Rep. 510; 44 N. W. Rep. 198; *ante*, § 2953.

[3] McKusick *v.* Seymour, 48 Minn. 172; *s. c.* 50 N. W. Rep. 1116.

[4] Poole *v.* West Point &c. Asso., 30 Fed. Rep. 513.

[5] Moss *v.* Averell, 10 N. Y. 449.

Article II. Defenses Affecting the Corporation and Its Management.

Section
3683. That the corporation had no legal existence.
3684. That the corporation has been guilty of illegal acts.
3685. That the corporate enterprise has been abandoned.

Section
3686. That the corporation has ceased to exist, etc.
3687. That the corporation changed its name after the defendant subscribed for the shares.
3688. That the corporate officers had been guilty of misconduct.

§ 3683. That the Corporation had no Legal Existence.— The almost universal rule is, that the stockholder, whether sued by the corporation itself for an assessment,[1] or by or on behalf of a creditor after the corporation has become insolvent or dissolved, is *estopped* from questioning the legal existence of the corporation.[2] The rule rests upon the twofold reason of the inconvenience of litigating the question of the legal existence of the corporation in an action not brought by the State for that purpose, and to which the corporation is not a party,[3] and that the stockholder ought not, as against those who have given credit to the body on the faith of its being what it has represented itself to be, to be heard to deny that it is such, he being a member of it, and in a degree responsible for such representations. Persons becoming stockholders in a corporation by innocently purchasing its shares on the market, without knowing the fact of its illegal organization, are clearly subject to the same rule of estoppel, as against its creditors; for it was their duty to ascertain the facts when they became members.[4] On the other hand, all judicial authority is agreed to the proposition that, *one who participates* in the irregular or fraudulent organization or operation of a corporation, cannot shelter himself from responsibility to its creditors by showing the invalidity of the organ-

[1] *Ante*, § 1863.

[2] Keyser *v.* Hitz, 2 Mackey (D. C.), 473; Hamilton *v.* Clarion &c. R. Co., 144 Pa. St. 34; *s. c.* 23 Atl. Rep. 53; 13 L. R. A. 779; National Commercial Bank *v.* McDonnell, 92 Ala. 387; *s. c.* 9 South. Rep. 149.

[3] Hamilton *v.* Clarion &c. R. Co., 144 Pa. St. 34; *s. c.* 23 Atl. Rep. 53.

[4] But see *ante*, § 3654.

ization.[1] On the same principle, it has been held that subscribers to the stock of corporations which never become fully organized because all the stock is not taken, but which are *merged*, with their consent, in a new corporation, cannot set up illegality of the merger, or the lack of corporate character of any or all of the companies, to defeat their liability as against creditors of the new company, after they have permitted it to incur liabilities.[2] So, a stockholder of a corporation is *estopped* from setting up, to relieve himself from personal liability for the corporate debts, that the corporation having failed to file with the Secretary of State the certificate within the time required by statute, its charter became *ipso facto* void.[3]

§ 3684. That the Corporation has been Guilty of Illegal Acts.— For the same reason, a stockholder cannot, in general, allege illegality in the acts of the corporation of which he is a member, as a bar to a recovery when sued by a creditor— as, that the excess of lands purchased by the corporation, a canal company, had been improperly divided among the stockholders.[4] So, although a banking company was required by its charter to have twenty-five per cent of its capital stock paid in before it should proceed to banking, yet the non-compliance with its charter in this particular did not constitute a valid defense, either for the corporation or for its stockholders, when sued on its bills.[5] So, it has been held that the failure of the subscribers to pay in the capital stock of a corporation within the time prescribed by law, subjects the corporation to proceedings for a dissolution, but has no application to the defense of an individual stockholder sued for the recovery of a debt of the corporation.[6] So, in a proceeding by receivers

[1] Marshall Foundry Co. *v.* Killian, 99 N. C. 501; *s. c.* 6 Am. St. Rep. 539; 6 S. E. Rep. 80; Beck *v.* Henderson, 76 Ga. 360.

[2] *Ibid.*

[3] National Commercial Bank *v.* McDonnell, 92 Ala. 387; *s. c.* 9 South. Rep. 149.

[4] Spear *v.* Crawford, 14 Wend. (N. Y.) 20; *s. c.* 28 Am. Dec. 513.

[5] Johnston *v.* South Western R. Bank, 3 Strobh. Eq. (S. C.) 263.

[6] Booth *v.* Campbell, 37 Md. 522.

of a bank against stockholders to compel them to pay up their stock, it is no ground of discharge that a violation of law was committed in assuming to do business under the act of incorporation, in pursuance of which the organization of the bank was effected or intended to be effected.[1] So, in an action by a creditor of a bank against a subscriber to its capital stock, the defendant cannot set up by way of defense that the by-laws and the stock subscriptions were illegal for the reason that the trustees who represented the bank at the time were not stockholders,—it appearing that the alleged subscribers *acquiesced* for years in the acts of the trustees, and allowed themselves to appear as subscribers.[2]

§ 3685. That the Corporate Enterprise has been Abandoned.—Whether this defense will be available depends upon principles more fully discussed when considering the action by the corporation for *assessments*.[3] It has been held that the abandonment of a railroad line is no defense to a suit for a stock subscription, in a proceeding supplementary to an execution against the company, inasmuch as the creditors may pursue the stockholders even after the corporate existence has ceased.[4] There is, however, a holding to the effect that where persons are induced by false representations to unite in the formation of a corporation, and as a step thereto sign and file with the county clerk a certificate of incorporation, but discover the falsehood of the representations and abandon the enterprise before any stock is subscribed and any thing further is done, these facts exempt them from liability for debts contracted in the name of the company, on a subsequent default to make and file the annual certificate. They are not liable, because,—1. There never was any such company, and the defendant never did any thing to create the belief that the company was organized; 2. At the time the alleged default arose the company had been abandoned.[5] So

[1] Voorhees *v.* Receivers, 19 Ohio, 463.

[2] Ross *v.* Bank, 20 Nev. 191; *s. c.* 19 Pac. Rep. 243.

[3] *Ante*, §§ 1975, 1976.

[4] Bish *v.* Bradford, 17 Ind. 490.

[5] Squires *v.* Brown, 22 How. Pr. 35, 47.

if, after one has subscribed to a scheme of incorporation, agreeing to take a number of shares therein when the corporation is formed, and if, between the time of the agreement and the grant of the charter, the law is so changed that the objects of agreement cannot be carried into effect, this releases the obligation of the subscriber, and he cannot thereafter be held by the company. The reason is that when, before the acceptance of the proposal, or before an attempt was made to accept it, it had become *illegal*, by reason of a change in the statute law, so that the power to accept was thereby taken away, the obligation was dissolved.[1] So, the subscribers to an organized charity cannot be compelled to pay over their subscriptions after the scheme of the charity has been essentially changed by legislative interference.[2]

§ 3686. That the Corporation has Ceased to Exist, etc. — It was held by an intermediate court in Missouri that an order of execution against a stockholder, under the Missouri statute, is a *nullity*, if it be made to appear on the motion for such execution that the corporation had ceased to exist at the time the judgment against it was rendered.[3] But the fact that a corporation has been *ousted* by a judgment in *quo warranto* proceedings, does not affect the right of its creditors nor the liability of its stockholders, in respect of its debts contracted prior to the judgment of ouster, though it may lead to a different procedure to enforce that liability:[4] the principle being that in respect of the liability of stockholders to creditors, there is no distinction between a *de jure* and a *de facto* corporation.[5] So, the fact that an insurance company has *passed into the hands of a receiver* diminishes in no degree the individual, superadded liability of a stockholder to a creditor

[1] Knox *v.* Childersburg Land Co., 86 Ala. 180; *s. c.* 5 South. Rep. 578.

[2] Printing House *v.* Trustees, 104 U. S. 711; *s. c.* Myer Fed. Dec., §§ 186, 188.

[3] Scanlan *v.* Crawshaw, 5 Mo. App. 337; followed in Buckland *v.* Nies, 8 Mo. App. 587.

[4] Rowland *v.* Meader Furniture Co., 38 Ohio St. 269; *ante*, § 3341.

[5] *Ibid.;* Gaff *v.* Flesher, 33 Ohio St. 107, 115; *s. c.*, on motion for rehearing, 33 Ohio St. 453; McCarthy *v.* Lavasche, 89 Ill. 270; *s. c.* 31 Am. Rep. 83.

of the company. He is not under the control or in the power of the receiver, but he holds a fund, so to speak, out of which the creditors of the company may be paid. The very fact that the corporation has gone into bankruptcy, or into the hands of a receiver, fixes the liability of a stockholder to a creditor of the corporation.[1] But this has no reference to the liability in respect of what is due on the shares of the stockholder. This is a debt owing to the corporation. It is a part of the assets of the corporation,[2] and it passes to its assignee in insolvency or to its receiver, and consequently cannot be subjected by an individual creditor where a proceeding in liquidation, by an assignee or receiver, is pending.[3] On sound principle, the rule extends even to a case where the corporation *could not* under any circumstances have existed as a corporation *de jure*, as where the charter was repugnant to the constitution. Here, on the soundest principle, this fact will not enable the stockholders to escape the liability they professed to assume, or disable the creditors from enforcing the security which they supposed they were getting; but the organization of a corporation under such a charter and the contracting of debts in its assumed corporate character, will operate as an *agreement* on the part of each coadventurer to become liable to creditors according to the terms of the charter; and when the creditors have given credit on the faith of that undertaking, an *estoppel* will arise, on just principles, against the stockholders, such as will prevent them from assuming any other relation.[4]

§ **3687. That the Corporation Changed Its Name after the Defendant Subscribed for the Shares.**—As already stated,[5] it will be no defense that, after the defendant subscribed for the shares, the corporation *changed its name.*[6] Where the defend-

[1] Arenz *v.* Weir, 89 Ill. 25.

[2] *Ante,* § 2952.

[3] Lionberger *v.* Broadway Savings Bank, 10 Mo. App. 499; Eppright *v.* Nickerson, 78 Mo. 482, 490; Boeppler *v.* Menown, 17 Mo. App. 447, 453; *ante,* § 3551.

[4] McCarthy *v.* Lavasche, 89 Ill. 270; *s. c.* 31 Am. Rep. 83.

[5] *Ante,* §§ 82, 1283.

[6] Howard *v.* Glenn, 85 Ga. 238; *s. c.* 21 Am. St. Rep. 156; 11 S. E. Rep. 610.

ant was sued on his alleged subscription to the capital stock of the "National Express and Transportation Company, under the name of the National Express Company," and defended on the ground that he subscribed only to the stock of the company last named,—it was held that the *burden of proof* was on the plaintiff to show the legal *identity* of the two companies; and that the minutes of the meetings of the subscribers to the company of which the defendant was a member, being properly identified, were admissible in evidence against him, for the purpose of showing that, in the incorporation of the second company, there was no material change or departure from the character and purposes of the corporation originally projected.[1]

§ 3688. That the Corporate Officers had been Guilty of Misconduct.—It would be a strange defense which would allow an obligor, when proceeded against on his obligation, to set up by way of defense the misprision *of his own agent or trustee*, with which the plaintiff is in no way connected. It is, therefore, in general, no defense for a stockholder, when proceeded against by a creditor of the corporation, to show that the officers of the corporation, although one of them is plaintiff in the suit, did not keep a full, fair, and correct account of the corporate affairs.[2] He cannot show that almost the entire amount of the outstanding indebtedness of the corporation, a savings bank, had been bought up by the officers of the bank at fifty cents on the dollar, they knowing that such indebtedness was illegal, because in excess of the amount which the bank was allowed to incur by its charter,—"said officers having full knowledge of the excessive indebtedness, when such excessive indebtedness was so incurred and the business of said alleged corporation so mismanaged."[3] One court has fallen into the wild dream of holding that this principle prevents the stockholder from showing that the contract

[1] Semple *v.* Glenn, 91 Ala. 245, 259; *s. c.* 24 Am. St. Rep. 894. Compare also, Lehman *v.* Glenn, 87 Ala. 618.

[2] Weber *v.* Fickey, 52 Md. 500.

[3] Stewart *v.* Lay, 45 Iowa, 604.

of subscription was procured by the fraud or misrepresentation of an agent of the corporation: reasoning that the members of a corporation are bound by the acts of its agents within the scope of their authority;[1] but forgetting that the stockholder was a *stranger* to the corporation when the fraud was perpetrated upon him, and that it is by virtue of the fraud itself that the creditor seeks to connect him with the corporation.

Article III. Defenses Affecting the Status and Liability of the Defendant as a Shareholder.

Section
3691. That the defendant never was a stockholder.
3692. When a shareholder estopped from making this defense.
3693. That the defendant did not become a stockholder in the regular mode.
3694. That some of the new stock was not taken.
3695. That some of the stock is owned by the corporation itself.
3696. That the full amount was not subscribed.
3697. That the subscription was made prior to the formation of the corporation.
3698. That the defendant became a stockholder after the debt was contracted.

Section
3699. That the defendant was a holder of preferred stock merely.
3700. That the shares were held by the defendant for another.
3701. That the shares were held for the corporation itself.
3702. That the defendant held the shares as pledgee of the corporation.
3703. That the stockholder is a sovereign State.
3704. That the officers are liable before stockholders.
3705. That one of the members of the company has died, it being unincorporated.
3706. That the stockholder had a right of renewal.
3707. That the stockholder was induced to subscribe by fraud.

§ 3691. That the Defendant never was a Stockholder.— This defense opens up a long inquiry, gone over in a previous title, as to what is necessary to constitute one a stockholder,[2] what will *estop* him from denying that relation,[3] and what will be *evidence* of that relation.[4] What follows here will consist merely of a collection of a few decided points that may have been overlooked there. A purchaser of new stock issued by a

[1] Saffold *v.* Barnes, 39 Miss. 399.

[2] *Ante,* § 1136, *et seq.*

[3] *Ante,* § 1877, *et seq.*

[4] *Ante,* § 1918, *et seq.;* and § 1936, *et seq.*

national bank, in order to *increase* its stock, which issue was never authorized by a vote of the stockholders, or approved or certified by the United States comptroller, is *not a stockholder, but a creditor*, and is hence entitled to recover judgment against the receiver for the amount paid by him, to be repaid out of the assets in the course of administration.[1] Stockholders in a corporation which has recorded articles providing for commencing business on less than the authorized capital, and that only a stated amount is required to be first paid in, who have paid for all the shares subscribed by them, and have not agreed to be bound for any other shares,—cannot be deemed subscribers to the *undisposed-of shares* and indebted therefor, for the purpose of rendering them individually liable for the corporate debts.[2] While, as already seen,[3] the delivery or tender of a certificate by the corporation to the subscriber is not at all necessary to make him a shareholder,[4] yet the fact that a *certificate* is tendered to him and is accepted and retained by him is sufficient *evidence* that he is a stockholder.[5] It is quite needless to add that one who has subscribed for shares in a corporation is none the less a shareholder, when proceeded against to enforce an individual liability, from the fact that he has not paid for his shares,[6] though, under some conceptions, the failure of the subscriber to pay the *deposit* required by the governing statute to be paid at the time of making the subscription, will prevent a liability as a shareholder from attaching to him,[7]—the general rule, however, being otherwise.[8] There is a very doubtful holding to the effect that one who has subscribed for shares cannot be made

[1] Schierenberg *v.* Stephens, 32 Mo. App. 314; Nichols *v.* Stephens, 32 Mo. App. 330.

[2] Sweney *v.* Talcott, 85 Iowa, 103; *s. c.* 52 N. W. Rep. 106.

[3] *Ante*, § 1140.

[4] Mitchell *v.* Beckman, 64 Cal. 117; *s. c.* 28 Pac. Rep. 110.

[5] McDowall *v.* Sheehan (Sup. Ct.), 36 N. Y. St. Rep. 104; *s. c.* 13 N. Y. Supp. 386.

[6] Mitchell *v.* Beckman, *supra*.

[7] *Ante*, § 1216. Compare Paterson *v.* Arnold, 45 Pa. St. 410.

[8] *Ante*, § 1224. That a *town* receiving stock of a railroad company in exchange for town bonds which the company sold, retaining the price received therefor, is, as against the company, the owner of the stock, although a portion of the bonds have been adjudged invalid in a suit by the

liable as a shareholder, although he has procured another person to take the shares in question in fulfillment of his subscription therefor, and has *voted* on the shares by virtue of a *proxy* from the other person, and has an executory agreement for the purchase of the stock which has not been fulfilled.[1]

§ 3692. When the Shareholder Estopped from Making This Defense.—As already shown,[2] if the shareholder has participated in the benefit of the shares, by receiving dividends or otherwise, he is generally *estopped*, as against the creditors of the corporation, from setting up the defense that he was not a shareholder.[3] But where the defendant *subscribed to new shares* which were to be issued by the corporation upon an increase of its capital stock, and instead of issuing the new shares to him, the managers procured certain old shares to be transferred by one of them to him, and he subsequently received dividends thereon, but without knowing the cheat that had been practiced upon him,—it was held that the reception of the dividends created no estoppel against him from denying that he was a shareholder, even after the insolvency of the company.[4] But it must be noted that this decision is opposed to the principle of law, already considered,[5] that the right of a shareholder to *rescind on the ground of fraud* ceases on the *insolvency* of the company, and is not available as against its creditors. In the case last considered it was also held that a stockholder in a national bank who subscribes and pays for certain additional shares of a proposed increase of stock, where no valid increase is made, is not estopped from claiming that he is not in fact a stockholder as to such additional shares, by the fact that the association has made false representations to the public that the stock has been increased.[6]

purchaser thereof against the town, the remainder of the bonds being valid, see Illinois &c. R. Co. *v.* Wade, 140 U. S. 65.

[1] Cormac *v.* Western White Bronze Co., 77 Iowa, 32; *s. c.* 41 N. W. Rep. 480.

[2] *Ante*, § 1877, *et seq.*

[3] Sanger *v.* Upton, 91 U. S. 56, 63.

[4] Stephens *v.* Follett, 43 Fed. Rep. 842.

[5] *Ante*, § 1440.

[6] Winters *v.* Armstrong, 37 Fed. Rep. 508.

§ 3693. That the Defendant did not Become a Stockholder in the Regular Mode.—In an action against a corporation and some of its stockholders, seeking to charge them individually, mere irregularities in the mode of becoming stockholders cannot avail such individuals, *if the corporation had waived* such informalities, and recognized them as legal stockholders.[1]

§ 3694. That Some of the New Stock was not Taken.—Where the directors of a national bank pass a resolution to *increase its stock,* giving its stockholders the right to take the new stock to an amount equal to that then held by them, the fact that some of the new stock is not taken is not sufficient ground for a particular stockholder to repudiate his new shares, taken by him as a shareholder, so as to escape statutory liability to creditors.[2]

§ 3695. That Some of the Stock is Owned by the Corporation Itself.—When part of the stock is owned by the bank itself, the individual stockholders are not, for that reason, liable to any further extent than they would have been if none of the stock had been so owned.[3]

§ 3696. That the Full Amount was not Subscribed.—We have already had occasion to consider the rule that if the full amount agreed to be raised has not been subscribed, the subscribers cannot be held to their contracts, because a man cannot be forced into a venture into which he did not agree to go.[4] Therefore, where the stock subscription fixes the amount of the capital to be raised, there is no liability on the part of a subscriber, unless such amount is subscribed, or there is a waiver by him of that part of the agreement;[5] and the rule is the same where the amount is fixed by the charter.[6] But it

[1] Holyoke Bank *v.* Goodman Paper Man. Co., 9 Cush. (Mass.) 576.

[2] Aspinwall *v.* Butler, 133 U. S. 595. See *ante,* § 2103.

[3] Crease *v.* Babcock, 10 Met. (Mass.) 525.

[4] *Ante,* § 1235, *et seq.;* § 1724, *et seq.*

[5] Rockland &c. Steamboat Co. *v.* Sewall, 78 Me. 167.

[6] Brand *v.* Lawrenceville Branch R. Co., 77 Ga. 506; *s. c.* 1 S. E. Rep. 255.

has been held that where the subscriptions are made upon the condition that a certain amount shall be subscribed, and that amount is nominally subscribed, but really not subscribed, because a small amount of the subscriptions are made by married women, and are hence void, those subscribers who became such subsequently to the subscriptions of the married women, and with knowledge of their subscriptions, cannot set up a failure of the condition, in a proceeding in equity against them by the creditors of the company to compel the payment of their subscriptions for the purpose of liquidating the debts of the company.[1]

§ 3697. That the Subscription was Made Prior to the Formation of the Corporation. — On principles already stated,[2] it will be no defense that the subscription was made prior to the formation of the corporation, and was hence in the nature of a *project* merely, provided the corporation was afterwards organized, and the subscription was *accepted* by it after its organization;[3] though a contrary theory obtains in some of the courts.[4] But it has been held in Canada that persons who signed a subscription for shares of a proposed company not yet incorporated, to whom no shares were ever allotted, and who were not named in the letters-patent of the company, are not chargeable as stockholders in winding-up proceedings, although their names were entered in the book as shareholders, and notice of meetings and demands for payment of calls were sent to them.[5]

§ 3698. That the Defendant Became a Stockholder after the Debt was Contracted. — It is, in general, no defense to

[1] Cornell's Appeal, 114 Pa. St. 153; *s. c.* 6 Atl. Rep. 258.

[2] *Ante*, § 1170.

[3] Marysville Electric Light Co. *v.* Johnson, 93 Cal. 538; *s. c.* 27 Am. St. Rep. 215; 29 Pac. Rep. 126; Minneapolis &c. Co. *v.* Davis, 40 Minn. 110; *s. c.* 12 Am. St. Rep. 701, and note; Anderson *v.* Newcastle &c. R. Co., 12 Ind. 376; *s. c.* 74 Am. Dec. 218, and note. But see Medler *v.* Albuquerque Hotel &c. Co. (N. M.), 28 Pac. Rep. 551.

[4] *Ante*, § 1162.

[5] Re London Speaker Printing Co., 16 Ont. App. 508; *s. c.* 31 Am. & Eng. Corp. Cas. 297.

an action by creditors to enforce the ordinary superadded statutory liability of the stockholders that the defendants became stockholders after the liability of the corporation to such creditors was incurred.[1]

§ 3699. **That the Defendant was a Holder of Preferred Stock Merely.** — Whether the holder of preferred stock is liable as a stockholder must depend upon an inquiry, already attempted,[2] into the question whether what was called preferred stock is in reality corporate *stock* or corporate *indebtedness;* and this must, in general, depend upon the scheme under which the preferred shares are issued. The general rule no doubt is, that holders of preferred stock of an insolvent corporation are subject to the statutory liability equally with the common stockholders.[3]

§ 3700. **That the Shares were Held by the Defendant for Another.** — The rule being that the one who holds the *legal title* is, as to all persons save the equitable owner, the shareholder,[4] it is no defense to a shareholder when proceeded against by or on behalf of a creditor of the corporation, in any form of proceeding, that he held the shares in trust for another. It has been so held under a statute[5] providing that "a person in whose name shares of stock stand on the books of a company shall be deemed the owner thereof as it regards the company."[6] But the rule would be the same without the aid of such a statute, for it does no more than declare the general rule of the law. Therefore, one who holds shares of stock for the real owner for the purpose of protecting it against seizure by the creditors of the owner, will not be heard to say, in case the corporation becomes insolvent and a judgment creditor of the corporation proceeds against him for an execu-

[1] Railroad Co. *v.* Smith, 48 Ohio St. 219; *s. c.* 31 N. E. Rep. 743. As to *present* and *past* stockholders, see *ante*, § 3169, *et seq.*

[2] *Ante*, § 2236, *et seq.*

[3] Railroad Co. *v.* Smith, 48 Ohio St. 219; *s. c.* 31 N. E. Rep. 743.

[4] *Ante*, § 3193.

[5] Va. Code of 1860, ch. 57, § 25.

[6] Hawkins *v.* Glenn, 131 U. S. 319, 335.

tion under a statute, that he is not the real owner of the stock, — especially where he has voluntarily placed himself on the books of the corporation as its owner.[1] On the other hand, where a man subscribes for shares in the names of persons *incapable of contracting*, as, for instance, in the names of his *infant* children, the law will not allow him thereby to escape liability; it will look behind the record and charge the real owner.[2]

§ 3701. That the Shares were Held for the Corporation Itself.—Whether this will be a defense on the part of the shareholder must depend upon conclusions touching the power of the corporation to deal with its own shares, which have already been considered.[3] If the vicious doctrine prevails in the particular forum that a corporation can be the general owner of its own shares, just as a man can be the owner of his own promissory note, and if the corporation sees fit to own, so to speak, its own shares, by having them vested in a trustee for its own use,—then it is difficult to say how such a court would answer this question; because a court that can fall into the aberration of holding that a man can be the owner of his own debt, can fall into any other species of judicial aberration. Again, if the corporation becomes temporarily the owner of its own shares, by reason of having taken them as a security for a debt, or by reason of having forfeited them from a defaulting shareholder, and, for the purpose of holding them temporarily, until they can be again disposed of, has them placed in the name of a trustee for its use, whether such trustee will, in the absence of statute, be exonerated from liability as a stockholder, must depend upon the application of various principles already considered,—one of which is, whether, the transaction being lawful and blameless, the shareholder ought not to carry out the real intent of the

[1] Erskine *v.* Loewenstein, 82 Mo. 301, 306; affirming *s. c.* 11 Mo. App. 595.

[2] Roman *v.* Fry, 5 J. J. Marsh. (Ky.) 634; Castleman *v.* Holmes, 4 J. J. Marsh. (Ky.) 1; *ante*, § 3202.

[3] *Ante*, § 2054, *et seq.*

parties, even as against creditors, there being no circumstances of estoppel. Again, in such a case it is necessary to consider whether there is a statute, such as exists in some of the States, exonerating from personal liability those who hold shares as trustees, and substituting the liability of the trust estate instead. The danger of holding stock for the corporation in this way, where there is no such statute, lies in the fact that, as against the public, the stockholder will be held to the liability which he has ostensibly assumed. This is illustrated by a case in Pennsylvania, where a statute provided that stockholders should be individually liable for the corporate debts to the amount remaining unpaid on their shares of stock. The company's certificate showed unpaid stock to a considerable amount, and there was no evidence that such amount had ever been paid. In an action against stockholders to recover a debt to the amount unpaid on the stock, it was held that it was no defense that the stockholders had paid for the shares held by them, and that the unpaid balance had been subscribed for by them as agents of the corporation, which it was to hold and sell at pleasure for its benefit. The cirtificate, which showed that the original stock had been subscribed by and for the stockholders, was conclusive as between them and the public, and could not be contradicted by the undisclosed arrangements between the stockholders and the corporation.[1]

§ **3702. That the Defendant Held the Shares as Pledgee of the Corporation.** — This subject has already been considered,[2] and it has been seen that in the view of some courts it is competent for a corporation to pledge its unissued shares for its own debt, under a contract which vests the pledgee with the rights of a shareholder, so that he can vote at its meetings in respect of its shares and be a director, and, as was done in one case, actually control its business operations,

[1] Allibone *v.* Hager, 46 Pa. St. 48, 53.

[2] *Ante*, § 2051, *et seq.*

without being liable as a shareholder, in the absence of an actual estoppel operating in favor of the particular creditor.[1]

§ 3703. **That the Stockholder is a Sovereign State.** — A sovereign State cannot be sued without its own consent, and then only in the particular mode and in the particular forum nominated by itself. The States of the American Union are sovereign States in respect of this immunity. If, therefore, a State has subscribed for stock in a corporation, and has not made payment, an action to compel payment does not lie against it, without its consent.[2] If, however, one of these States has, by its consent, rendered itself liable to a private action, — and this is purely a question of local law, to be determined by an inspection of its constitution and statutes, — and if it has become a stockholder in a private corporation, it has subjected itself to the same liabilities which, under the foregoing rules, attach to any private stockholders.[3] This rule was applied where the State of Arkansas created a bank called the State Bank of Arkansas, and owned all of its capital, — that is, was the sole stockholder therein. The bank became insolvent, and afterwards the Legislature, by various acts, withdrew, from time to time, portions of its specie and assets, and applied them to the uses of the State. It was held by the Supreme Court of the United States — reversing the Supreme Court of Arkansas — that the State occupied toward the creditors of the bank, of whom the complainant was one, the same relation as though it had been a private stockholder; that the acts of its Legislature in question impaired the obligation of the contract subsisting between the bank and the complainant, and were hence void.[4]

[1] Burgess *v.* Seligman, 107 U. S. 20; Union Savings Asso. *v.* Seligman, 92 Mo. 635; *s. c.* 1 Am. St. Rep. 776; 13 S. W. Rep. 630; reversing *s. c.* 11 Mo. App. 142, and overruling Griswold *v.* Seligman, 72 Mo. 110.

[2] Miers *v.* Zanesville &c. Co., 11 Ohio, 273; Bresler *v.* Butler, 60 Mich. 40; *s. c.* 26 N. W. Rep. 825.

[3] Curran *v.* State, 15 How. (U. S.) 304. See Robinson *v.* Bank of Darien, 18 Ga. 65, 109.

[4] *Ibid.* See, to the contrary, Robinson *v.* Bank of Darien, 18 Ga. 65.

§ 3704. That the Officers are Liable before Stockholders. — A statute of Massachusetts provided as follows: "Upon any execution issued on any judgment recovered against any corporation, the stockholders whereof are liable for its debts, or any part thereof, in which a demand has been made pursuant to law, and the said execution is not satisfied, the person or property of any officer of the said corporation at the time when the cause of action accrued, or when the said judgment was rendered, may be taken; and if no property of such officer can be found to satisfy the said execution, then the person or property of any stockholder may be taken thereon."[1] This statute limited the recourse of the creditor against the general stockholders to the contingency that the officer could find neither property of the corporation nor of any of its officers, on which to levy. When a sheriff levied an execution against the corporation, or the property of a stockholder, while there were two officers who had been proceeded against, he was held liable in an action of tort.[2] But a stockholder, summoned in an action by a creditor against the corporation, could not defend the action as to himself, by showing that there were officers of the corporation having sufficient property to pay the claim; since the officers might, by conveying away their property, evade liability before execution issued, in which case the general stockholder would become liable to execution.[3]

§ 3705. That One of the Members of the Company has Died, It being Unincorporated. — If, by the articles of a trading association, it is apparent that it was designed to consist of many members, who might, from time to time, cease to be interested in the company by voluntary withdrawal or death, and that the same business should be continued by those who remain, and by such as might be added to their number, under the terms of the articles, the death of one of them does not relieve others from liability to contribute for debts subsequently contracted without their consent or knowledge.[4]

[1] Stat. Mass. 1851, ch. 315, § 3; Gen. Stat. 1860, ch. 60, § 34.

[2] Denny *v.* Richardson, 4 Gray (Mass.), 274.

[3] Brayton *v.* New England Coal Mining Co., 11 Gray (Mass.), 493.

[4] Tyrrell *v.* Washburn, 6 Allen (Mass.), 466.

§ 3706. That the Stockholder had a Right of Renewal.—It has been held, under a bank charter, that notes given by a stockholder to represent a stock loan, identified by *authentic act* with the original stock mortgage, are fully secured by the stock mortgage, which is binding as a loan mortgage, even on third parties, without an *inscription* of the new act in the proper office. The failure, neglect, or refusal of a stockholder of that bank to pay the stipulated installment and interest on his loan when due, operates itself as a forfeiture of his right to *renew* his stock loan note, which then becomes due and exigible, according to law, in capital and interest of ten per cent.[1]

§ 3707. That the Stockholder was Induced to Subscribe by Fraud.— This subject has been traced in a former chapter,[2] with the conclusion that *where the corporation has ceased to be a going concern,* and the proceeding against the stockholder is by one who represents creditors, and who consequently stands in a higher right than that of a mere representative of the corporation, this defense is unavailing to the stockholder; and it has been so held where the proceeding was by an assignee in bankruptcy,[3] and also where it was by a receiver,[4] or trustee representing the creditors.[5] The distinction which exists between the case where the shareholder proceeds seasonably in equity for a rescission of his contract of subscription, and the case where he delays and takes his chances until the corporation has become insolvent and the rights of its creditors have supervened, is illustrated by a modern case, where, in an action for a rescission seasonably brought, it was held that the representation by a *promoter* of a corporation, made to the subscriber as an inducement to his subscription to its capital stock, that a person named, of wide reputation for his sagacity in business affairs, had agreed to subscribe for a

[1] Mitchell *v.* Logan, 34 La. Ann. 998.

[2] *Ante*, § 1360, *et seq.*

[3] Michener *v.* Payson, 13 Nat. Bank. Reg. 49. See, especially, *ante*, § 1440.

[4] Ruggles *v.* Brock, 6 Hun (N. Y.), 164.

[5] Howard *v.* Glenn, 85 Ga. 238; *s. c.* 21 Am. St. Rep. 156; 11 S. E. Rep. 610. See, especially, the decision of the House of Lords in Tennent *v.* Glasgow Bank, 4 App. Cas. 615.

large amount of the same stock, without disclosing the fact that the stock was *given* to such person as a gratuity for the use of his name, is such a fraud as will entitle the plaintiff to a rescission.[1] Outside of the question of fraud, secret representations of the agent or promoter procuring the subscription are not admissible to vary its terms where it is taken in writing, and consequently form no defense by the shareholder to an action against creditors.[2]

ARTICLE IV. DEFENSES AFFECTING THE DISCHARGE AND RELEASE OF THE SHAREHOLDER.

SECTION
3711. That the defendant has paid his subscription in full.
3712. That such payment was made in property, services, etc.
3713. That the defendant has discharged his liability by payment to other creditors.
3714. Further of this subject.
3715. That the defendant purchased the shares in good faith, believing them to have been fully paid up.
3716. Burden of showing non-payment.
3717. Manner of proving payment.
3718. That the defendant was released from his obligation by the corporation.
3719. That the personal liability of the stockholders has been waived or released by contract.
3720. Interpretation of such contracts of waiver.
3721. That the defendant's liability was divested by transfer.
3722. That the defendant has been discharged in bankruptcy.
3723. Whether assignee in bankruptcy can be made a contributory.
3724. Assignee not bound to indemnify bankrupt against calls.
3725. That the defendants are entitled to be discharged as sureties.

§ 3711. That the Defendant has Paid his Subscription in Full.—This subject is extensively considered elsewhere.[3] In whatever form of proceeding against the stockholder by a creditor of the corporation, it is a sufficient defense that by the articles of incorporation—assuming that this clause in them is warranted by the governing statute—the stockholders are not individually liable beyond the amount of unpaid stock subscribed for by them, and that defendant's subscrip-

[1] Coles *v.* Kennedy, 81 Iowa, 360; *s. c.* 25 Am. St. Rep. 503; 46 N. W. Rep. 1088; 9 Rail. & Corp. L. J. 14.

[2] Payson *v.* Withers, 5 Biss. (U. S.) 269; *ante*, § 1395.

[3] *Ante*, § 1562, *et seq.*

tion has been fully paid.[1] And so in any case where the amount which the law requires the stockholder to pay, whether it be the unpaid purchase price of his shares or a superadded individual liability, has been exhausted by valid payments, whether to the corporation or to its representative, or to a creditor or creditors,—he cannot be compelled to pay more. Moreover, in cases where the creditor proceeds by garnishment, and where the liability of the stockholder consequently depends upon a call, it will on principle, and on one holding (afterwards overruled in the jurisdiction where it was pronounced),[2] be a good defense that the stockholder has paid up all the calls that have been made.[3] And where the shares have been paid for, either in money or in property, there is no principle of law which will prevent the shareholder from returning or donating them to the corporation, and which will prevent the corporation from reissuing them, either by selling them at a reduced price,[4] or issuing them as a *bonus to subscribers* to its bonds;[5] and the original shareholder will not in such a case become personally liable in respect of the shares, on the ground that they were issued in violation of a constitutional provision prohibiting corporations from issuing their shares except for payment in money, or in property at a reasonable value.[6] Although the doctrine has gained footing, as already seen,[7] that a corporation, after it becomes organized, can sell its unissued shares at any price which it can get, and that, in the absence of circumstances of estoppel, the purchaser will not be liable for the difference between what he actually gave for them and their real value,—yet more recently the doctrine has been reaffirmed that the trust arising in favor of creditors by subscriptions to the stock of a corporation cannot be defeated by a *simulated payment* of such subscriptions, or by any device short of an actual payment in

[1] Spense *v.* Iowa &c. Construction Co., 36 Iowa, 407; Toner *v.* Fulkerson, 125 Ind. 224; *s. c.* 25 N. E. Rep. 218.

[2] *Ante*, § 3454.

[3] Bingham *v.* Rushing, 5 Ala. 403.

[4] Memphis &c. R. Co. *v.* Dow, 120 U. S. 287, 299.

[5] Davis *v.* Montgomery Furnace &c. Co. (Ala.), 8 South. Rep. 496.

[6] *Ibid.*

[7] *Ante*, § 1665, *et seq.*

good faith.[1] Upon this principle it has been held that a subscriber cannot, as against creditors, discharge his liability for his subscription by *substituting shares* paid up by another subscriber.[2] But where a subscriber for shares in the capital stock of a railroad company refused to pay the assessments on the shares, and the company, instead of declaring them forfeited, procured subscriptions from other persons to the full amount of the capital stock, it was held that the company could not sell the shares and sue the subscriber for the difference between the assessment and the sum for which the shares were sold, under the Massachusetts Statutes, chapter 63, section 9.[3] As *value* is largely a matter of *opinion*, and regularly proved by the *opinions* of witnesses,[4] there is possibly not so much difference between these two supposed theories as might seem at first blush. At all events, there seems to be a tendency to concur in the view that where stock has been issued to a stockholder, and settled for by him under an arrangement made in good faith with the company, it is not in the power of a creditor, in all cases and as a matter of right, to disturb the arrangement so made, on the ground that, in the light of subsequent events, it was a disadvantageous one, and especially where such creditor knew of the transaction at the time and acquiesced in it.[5]

§ 3712. That Such Payment was Made in Property, Services, etc. — What payment for shares in specific property, services, or commodities other than money, which the corporation is entitled to receive, will discharge the shareholder, has been the subject of consideration in a former title.[6] We have had occasion in that discussion to note two theories upon this subject, one of which may be called "true value

[1] Camden *v.* Stuart, 144 U. S. 104.

[2] Marshall Foundry Co. *v.* Killian, 99 N. C. 501; *s. c.* 6 Am. St. Rep. 539; 6 S. E. Rep. 80.

[3] Athol &c. R. Co. *v.* Prescott, 110 Mass. 213.

[4] 1 Thomp. Trials, § 380.

[5] Coit *v.* Gold Amalgamating Co., 14 Fed. Rep. 12; *s. c.* affirmed, 119 U. S. 343; Davis *v.* Montgomery Furnace &c. Co. (Ala.), 8 South. Rep. 496; Memphis &c. R. Co. *v.* Dow, 120 U. S. 287, 299.

[6] *Ante*, § 1604, *et seq.*

theory,"[1] and the other "the good faith theory."[2] Under the former theory, shares of stock issued by a corporation to its stockholders, in exchange for property of less value than the par value of the stock, are *chargeable* by the corporation's creditors *with the difference* between the value of the property taken and the par value of the stock, regardless of the question of actual fraud.[3] Under this theory the *motive* of the coadventurers is not considered, but the law annexes the conclusion of fraud where property or services were received for the shares at a clearly inadequate valuation. It has been reasoned that the issue of the shares of a corporation for a wholly inadequate consideration is as much a fraud upon its creditors as though the corporation had disposed of any other debt due it for a wholly inadequate consideration; and that such a fraudulent holder of stock is liable to the creditors for its par value, less what he has paid for it to the corporation.[4] The other theory, so destructive of the rights of creditors, is, that whatever the coadventurers, *in good faith*, agree to be the true valuation of the property received for the shares, is such valuation.[5] Under either of these theories, in an action against a stockholder of an insolvent corporation to compel them to contribute to the payment of its debts, it is only necessary, in order to make out a *prima facie* case, to establish that they have not in good faith paid the par value for the stock of the corporation.[6]

§ 3713. That the Defendant has Discharged his Liability by Payment to Other Creditors. — We have already seen that the liability of a stockholder, though sometimes joint and

[1] *Ante*, § 1616.

[2] *Ante*, § 1618.

[3] Farmers' Bank *v.* Gallaher, 43 Mo. App. 482; Gogebic Investment Co. *v.* Iron Chief Min. Co., 78 Wis. 427; *s. c.* 23 Am. St. Rep. 417.

[4] *Ibid.*

[5] Coit *v.* Gold Amalgamating Co., 119 U. S. 343; affirming *s. c.* 14 Fed. Rep. 12. See, also, Holly Man. Co. *v.* New Chester Water Co., 48 Fed. Rep. 879.

[6] Gogebic Investment Co. *v.* Iron Chief Min. Co., 78 Wis. 427; *s. c.* 23 Am. St. Rep. 417. In addition to what has already been said (*ante*, §§ 1648, 1649) about the payment of shares in *newspaper puffing and advertising*, see Andres's case, 8 Ch. Div. 126; 47 L. J. Ch. 679; 38 L. T (N. S.)

several, like that of a partner,[1] is, in general, *several, and not joint.*[2] And, although in most of the statutes, and in the loose language of the judicial decisions, the limited statutory liability of the stockholder is said to be joint and several, yet it is clear that this means that the liability is joint only in the sense that several may be proceeded against at once, and that if any one is, in any event, compelled to pay more than his share, he may have contribution from the others. Accurately speaking, this liability is several, whether it consists of unpaid installments due upon stock held, or whether it be the superadded liability created by statute. In either case, the amount for which each stockholder is liable depends upon the amount of stock held by him; and although, for convenience of litigation, all or many are joined in one proceeding, the liability of each is separately ascertained, and a *several* judgment or decree is rendered against each. Each stockholder, then, unless his position is that of a mere partner under some exceptional statute or charter, is liable to pay, towards liquidating the debts of the company, a given amount, and no more. If he has paid this amount, either to the corporation, where it consists of the balance due on his share subscription,[3] or to a creditor or creditors entitled to call upon him to make such payment, whether it consist of such unpaid balance or of a superadded statutory individual liability, — his liability is at an end, and he may successfully plead such payment when proceeded against by any other shareholder.[4] But he must be careful not to make payment to one creditor where another has a prior right to, or lien upon, the sum which he is liable

266; 26 Week. Rep. 567; Spargo's case, L. R. 8 Ch. 407; White's case, 10 Ch. Div. 720; and 12 Ch. Div. 511; Mudford's Claim, 14 Ch. Div. 634.

[1] *Ante*, § 3080.

[2] *Ante*, § 3086, *et seq.*

[3] Veeder *v.* Mudgett, 95 N. Y. 295; Sutherland *v.* Olcott, 29 Hun (N. Y.), 161; Wellington *v.* Continental Const. &c. Co, 52 Hun (N. Y.), 408; *s. c.* 24 N. Y. St. Rep. 678; 5 N. Y. Supp. 587.

[4] Garrison *v.* Howe, 17 N. Y. 458; Grose *v.* Hilt, 36 Me. 22 (case governed by statute); Jones *v.* Wiltberger, 42 Ga. 575; Tallmadge *v.* Fishkill Iron Co., 4 Barb. 382; Robinson *v.* Bank of Darien, 18 Ga. 65, 109; Hall *v.* Boyd, 52 Ga. 456; Lane *v.* Harris, 16 Ga. 217; Sackett's Harbor Bank *v.* Blake, 3 Rich. Eq. 225. So, by statute in California: Larrabee *v.* Baldwin, 35 Cal. 155.

to pay. Such a payment will be deemed to have been made in his own wrong, and he will be compelled, notwithstanding it, to make payment to the creditor having the prior right.[1]

§ **3714. Further of This Subject.** — As the creditor who first proceeds against an individual stockholder does not, by merely bringing his action, *impound*, so to speak, enough of what is due by the stockholder to satisfy his demand, nor get any *lien* on the same,[2] — it will be a good defense that *after the suit was brought*, the defendant had paid the full amount of his liability to another creditor of the corporation;[3] and what he has been compelled to pay to other creditors, under judgments obtained against him, may be shown in *reduction* of the amount which he may be compelled to pay in a particular case.[4] So, it has been held, in an action brought against a stockholder, who is bound for the ultimate redemption of the bills issued by a bank "in proportion to the amount of shares and the value thereof that each individual or company may hold in said bank," where the record does not show that other bills of the bank are due and unpaid, nor that there has been any recovery against such stockholder upon bills of the bank, that the plaintiff is entitled to recover his whole claim, if it does not exceed the par value of stock the defendant owns; and that such payment may be pleaded in bar of subsequent actions.[5] But this defense was held unavailing where the stockholders had joined together and raised a sum, by way of *donation*, so to speak, *to the corporation*, to be used in liquidating its debts, and the defendant stockholder had, in this way, paid an amount equal to his superadded statutory liability, — the question turning upon the intention of the parties.[6] Nor did the payment of a *special tax* imposed in aid of the corporation, the holders of the tax receipts to become stockholders in the company for the amount thereof, release the stock-

[1] *Post*, § 3838, *et seq.*

[2] *Post*, § 3840.

[3] Richards *v.* Brice, 22 N. Y. St. Rep. 289; *s. c.* 3 N. Y. Supp. 941; Young *v.* Brice, 18 N. Y. St. Rep. 945; *s. c.* 3 N. Y. Supp. 123.

[4] Garling *v.* Baechtel, 41 Md. 305.

[5] Lane *v.* Harris, 16 Ga. 217.

[6] Fowler *v.* Robinson, 31 Me. 189.

holders from the obligations contracted by them under the charter.[1] Nor, under a statute of Maine, could any payment of a debt of a corporation by a stockholder avail him, in a suit against him by a creditor, if made before the date of the certificate of the officer, on the execution against the corporation, that he could not find property of the corporation whereon to levy.[2]

§ 3715. That the Defendant Purchased the Shares in Good Faith Believing Them to have been Fully Paid up. — Under principles already considered,[3] where the object of the suit is merely to subject what is alleged to be unpaid in respect of the shares held by the defendant, it will be a good defense on his part that the shares were issued by the corporation as paid up, and that he purchased them in the ordinary course of business, in good faith, for a valuable consideration, believing them to have been actually paid up.[4]

§ 3716. Burden of Showing Non-payment. — In any action by a creditor to charge a stockholder with liability for the debts of the corporation, the burden of proving non-payment of the shares of the defendant is *on the creditor*, unless on the pleadings the non-payment is admitted and sought to be avoided.[5] Thus, if it appears that the shares were paid for in property conveyed by the stockholder to the corporation, it will be presumed, in the absence of evidence to the contrary, that the property was conveyed at an adequate valuation,[6] — and this, of course, casts the burden of impeaching the transaction upon the creditor. So, where the shares were

[1] New Orleans &c. R. Co. *v.* Lea, 12 La. Ann. 388.

[2] Grose *v.* Hilt, 36 Me. 22.

[3] *Ante*, § 1680, *et seq.*

[4] Burkinshaw *v.* Nicolls, 3 App. Cas. 1004; *s. c.* 26 Week. Rep. 819; 39 L. T. (N. S.) 308; affirming *s. c.* 7 L. R. Ch. Div. 533; 47 L. J. Ch. 415; 26 Week. Rep. 334.

[5] This is the rule in actions in New York to enforce the statutory liability on the ground that he has not paid in full for his shares. Wellington *v.* Continental Const. &c. Co., 52 Hun (N. Y.), 408; *s. c.* 24 N. Y. St. Rep. 678; 5 N. Y. Supp. 587. But see *ante*, § 1950, for the contrary rule where the *corporation* is suing for assessments.

[6] Davis *v.* Montgomery Furnace &c. Co. (Ala.), 8 South. Rep. 496.

issued by the corporation as paid-up shares, and it is sought to charge a *purchaser* of them on the ground that when he purchased them he had *notice* that they were not paid up, the creditor or his representative will sustain the *burden of proving that the purchaser had notice* that they were not paid up.[1]

§ **3717. Manner of Proving Payment.**—In a suit to charge a shareholder in a banking corporation with his proportion of its debts, where he pleads that he has paid such proportion to other depositors than the plaintiff, he may prove such payment by producing the original evidences of deposit which he has thus taken up; or he may do it by producing a certificate of the assignee of the bank of the fact of the indebtedness, together with the oath of the assignee that he has surrendered to such assignee such evidences of deposit, with the receipts thereon given to the defendant by the holders of them.[2]

§ **3718. That the Defendant was Released from his Obligation by the Corporation.**—Defenses of this kind are generally futile, except in the cases of a *bona fide compromise* between the corporation and the shareholder *of a disputed claim*,[3] the doctrine being that the capital stock of a corporation, and especially its unpaid subscriptions, is a *trust fund* for the benefit of its general creditors. It follows, as a necessary inference, in the language of the Supreme Court of the United States,—"that the governing officers of a corporation cannot, by agreement or other transaction with the stockholder, release the latter from his obligation to pay, to the prejudice of its creditors, except by fair and honest dealing and for a valuable consideration."[4] Moreover, on principles already discussed,[5]

[1] Burkinshaw *v.* Nicolls, 3 App. Cas. 1004.

[2] Jones *v.* Wiltberger, 42 Ga. 575.

[3] *Ante*, §§ 1511, 1553.

[4] Sawyer *v.* Hoag, 17 Wall. (U. S.) 610; *s. c.* 10 Myer Fed. Dec., § 152. The extent to which the same court has gone in breaking down this salutary doctrine has been considered by the author in a former title (*ante*, § 1665, *et seq.*). The doctrine of the text is maintained in its full vigor by some of the State courts. Gogebic Investment Co. *v.* Iron Chief Mining Co., 78 Wis. 427; 23 Am. St. Rep. 417; Republic Life Ins. Co. *v.* Swigert, 135 Ill. 150; *s. c.* 25 N. E. Rep. 680.

[5] *Ante*, § 1395, *et seq.*

no extrinsic or collateral agreements between a subscriber and the *promoters* or agents of a corporation, who obtained his subscription for capital stock, which is absolute on its face, unless they amount to fraudulent representations, can discharge or reduce his liability as a stockholder.[1] Nor does the question whether the creditor was such before or after the attempted release necessarily affect the question, though his position is undoubtedly strengthened if he became a creditor subsequent to the attempted release and without knowledge of it. A fraudulent release by a corporation of an unpaid subscription to an increase of its capital stock is void, even as against a debt arising before the stock was so increased.[2] Therefore, a resolution by a board of directors of an insurance company, that all the stockholders who should pay five per cent on their respective shares, and surrender their certificates to the company, should have the privilege of retiring from the company and withdrawing their stock notes, was void; and it was none the less void, because there may have been enough assets left to pay all the creditors; the governing principle being, that the directors of a corporation are its agents with limited powers, conferred upon them for the purpose of conducting the affairs of the company, and promoting the end of its creation; which does not include any power to give away its funds, thus depriving it of the means of prosecuting its business; and that the stockholders have a right to claim that other stockholders should not be released by the directors without their consent.[3]

§ 3719. That the Personal Liability of the Stockholders has been Waived or Released by Contract.— The fact that the articles of association of the corporation exonerate the stockholders from personal liability makes no difference.[4] It

[1] Ollesheimer *v.* Thompson Man. Co., 44 Mo. App. 172.

[2] Carter *v.* Union Printing Co., 54 Ark. 576; 16 S. W. Rep. 579.

[3] Gill *v.* Balis, 72 Mo. 424; citing and following the principle laid down in Spackman *v.* Evans, L. R. 3 H. L. 186; and Bedford R. Co. *v.* Bowser, 48 Pa. St. 29; denying Dorr *v.* Stockdale, 19 Iowa, 269.

[4] *Ante*, § 2926.

is not competent to the stockholders thus to establish a private contract *among themselves* which can put them beyond the power of the Legislature under the reservation contained in the general act.[1] But the security of the superadded individual liability of the stockholders is undoubtedly one which the *creditors may waive;*[2] and no reason exists why a particular creditor may not waive this security by a contract with the corporation. In such a case the corporation would be understood as making stipulation for the benefit of its stockholders and as their agent. Nor is this rule changed by the fact that the personal liability of the stockholders is created by a clause in the *constitution* of the State. It has been held that this result is reached by the insertion of a stipulation to that effect in *all* the contracts of the corporation.[3] Such a waiver would, of course, be ineffectual if it could be *merged*, or rather *submerged*, by the recovery of a judgment against the corporation. Clearly, as such a judgment does not in its nature adjudicate the question of the ulterior liability of the stockholders to satisfy it, it does not estop them from showing that there was such a condition in the contract; to this extent they may go behind the judgment.[4]

§ 3720. Interpretation of Such Contracts of Waiver. — It has been held that a provision in bonds issued by a corporation, that no stockholders shall be individually liable thereon, does not exempt them from the obligation of paying any *unpaid balance* due to the company for the benefit of creditors

[1] Matter of Lee & Co. Bank, 21 N. Y. 9; Matter of Reciprocity Bank, 22 N. Y. 9.

[2] *Ante*, § 3008.

[3] French *v.* Teschemaker, 24 Cal. 518.

[4] A promissory note, signed with the name of a corporation by its treasurer, and indorsed with its name by its directors, was delivered to a person, under an oral agreement between him and the corporation "that there should be no personal liability on the note." He afterwards recovered judgment against the corporation in an action at law upon the note. It was held, on a bill in equity against the stockholders of the corporation, to enforce payment of the judgment, that it was meant that there should be no statutory liability on the part of the stockholders; and that this agreement was admissible in defense, and was not merged in the judgment. Brown *v.* Eastern State Co., 134 Mass 590.

holding judgments upon the bonds, but that it refers only to their statutory individual liability.[1]

§ 3721. That the Defendant's Liability was Divested by Transfer.—This reopens an extensive subject already considered.[2] Roundly stating the governing principle, it is that if the stockholder had made an out-and-out *bona fide* transfer of his shares, prior to the time when the corporation contracted the particular debt, he is not liable to the creditor; and he is entitled to show this fact; and it is error to exclude evidence offered by him to that end.[3]

§ 3722. That the Defendant has been Discharged in Bankruptcy.—It may be assumed that where, in case of the bankruptcy of the stockholder, his shares pass to his assignee, to be disposed of with the rest of his estate, for his creditors, and he receives his discharge from the court of bankruptcy, this will end his contractual liability in respect of the shares.[4] But the rule does not compel an *assignee* in bankruptcy to *accept onerous property* of the bankrupt;[5] and it does not, therefore, follow, from the mere fact that the person has been discharged in bankruptcy, that his title to shares held by him in

[1] Preston *v.* Cincinnati &c. R. Co., 36 Fed. Rep. 54; *s. c.* 1 L. R. A. 140.

[2] *Ante*, § 3221, *et seq.*

[3] In an action by the creditor of a manufacturing corporation to enforce the liability of a stockholder for the amount unpaid on his stock, under Laws N. Y. 1848, ch. 40, § 10, the exclusion of evidence offered by defendant to prove the sale and transfer of her stock before the indebtedness of the company accrued, is prejudicial error; for, if established, the transfer would have been a complete defense to the action. Tucker *v.* Gilman, 121 N. Y. 189; *s. c.* 24 N. E. Rep. 302; affirming *s. c.* 45 Hun (N. Y.), 193.

[4] Marr *v.* West Tennessee Bank, 4 Lea (Tenn.), 578, 588, 589.

[5] South Staffordshire R. Co. *v.* Burnside, 5 Exch. 129; Ex parte Davis, 3 Ch. Div. 463; Streeter *v.* Sumner, 31 N. H. 542; Amory *v.* Lawrence, 3 Cliff. (U. S.) 523; Rugely *v.* Robinson, 19 Ala. 404; Levi *v.* Ayers, 3 App. Cas. 842; Turner *v.* Richardson, 7 East, 335 (case of a lease chargeable with rent); Wheeler *v.* Bramah, 3 Camp. 340 (a similar case); Martin *v.* Black, 9 Paige (N. Y.), 641 (receiver not bound to accept onerous lease, though if he takes it, he takes it *cum onere*). See, generally, to the same principle, Gibson *v.* Carruthers, 8 Mees. & W. 321, 333. Under the modern English rule he is allowed, when he finds the burden unprofitable, to unload it: Ex parte Davis, 3 Ch. Div. 463.

a corporation has been divested, or that his contingent liability in respect of such shares has been dissolved by his discharge.[1] It follows that, in a proceeding to charge a stockholder, a *plea of bankruptcy* will not be good unless it alleges the assignment of the shares to the assignee in bankruptcy.[2] Moreover, where the contract of subscription pursues the usual form, and consists of an agreement to pay in such installments as may be required, a discharge in bankruptcy will not bar an action for installments not called for prior to the discharge; since such uncalled-for installments were not provable in the bankruptcy proceeding against the defendant's estate.[3] Nor will a discharge under the insolvency laws of one State operate to release resident stockholders of the corporation domiciled in another State, and existing under the laws of such other State. Thus, a discharge under the insolvent law of Maryland will not release from liability a stockholder of a Virginia corporation who resides in Maryland, although the remedy against him is sought in the courts of Maryland.[4]

§ 3723. Whether Assignee in Bankruptcy can be Made a Contributory.—The answer to this question seems to depend upon an inquiry whether the assignee actually *accepted the shares*, as elsewhere stated.[5] An assignee in bankruptcy is *not bound to accept onerous property* of the bankrupt, but has his election to accept or reject it, and this doctrine applies to corporate shares. In order, then, to charge the assignee, or, more strictly, the assigned estate in his hands, with any liability in respect of the shares, it is necessary to show that the assignee elected to accept them; and the mere fact that he took possession of the estate of the bankrupt, under a general assignment of all his estate, does not amount to such an election.[6]

[1] Furdoonjee's case, 3 Ch. Div. 264.

[2] Glenn *v.* Howard, 65 Md. 40, 51; *s. c.* 3 Atl. Rep. 895.

[3] Glenn *v.* Howard, *supra.*

[4] Glenn *v.* Clabaugh, 65 Md. 65; *s. c.* 3 Atl. Rep. 902.

[5] *Ante*, § 3208.

[6] Levi *v.* Ayers, 3 App. Cas. 842; American File Co. *v.* Garrett, 110

§ 3724. Assignee not Bound to Indemnify Bankrupt against Calls.—In the absence of a special acceptance of the shares by the assignee in bankruptcy, and possibly without reference to it, the assignee is not bound, either personally or out of the assigned estate, to indemnify the bankrupt in respect of calls which he has been made to pay upon the shares; for, as was said by Sir Barnes Babcock, "it seems to be quite contrary to the principle of the laws relating to bankrupts or insolvents that the assignee taking the property for division amongst his creditors should be liable, either personally or out of the assets of the estate, to indemnify the bankrupt or insolvent in respect of any claims to which he may have rendered himself liable in respect of a particular portion of the estate, and from which claims he has not been discharged by his bankruptcy or insolvency."[1]

§ 3725. That the Defendants are Entitled to be Discharged as Sureties.—Where the stockholders have, in order to gain credit for the corporation, *guaranteed its indebtedness,* it seems that they will not be allowed to set up, by way of defense, when sued upon their contract of guaranty, matters which would operate to discharge them if they were sureties for a third person merely; the reason being that they ought to be regarded as borrowers of the money, and, in a sense, as *principal debtors,* rather than as sureties whose liability is *strictissimi juris.*[2]

U. S. 288, 295. In the former of these cases, it was held by the House of Lords, under an Australian statute of insolvency, that an acceptance of the shares of the insolvent by his assignee was not constituted by the mere execution of the deed of transfer, by the acceptance of the trusts thereunder, and a general action in relation to those trusts, in the absence of any special acts done in relation to the shares. Levi *v.* Ayers, *supra.*

[1] Levi *v.* Ayers, 3 App. Cas. 842, 855. See, also, Wilkins *v.* Fry, 1 Mer. 244.

[2] See, for an illustration, National Exchange Bank *v.* Gay, 57 Conn. 224; *s. c.* 4 L. R. A. 343; 17 Atl. Rep. 555. The writer does not think it necessary to go further into an analysis of this case, because it relates to a question which lies somewhat outside of the mere relation of corporation and stockholder.

ARTICLE V. DEFENSES AFFECTING THE PLAINTIFF'S DEMAND.

SECTION
3729. That the judgment against the corporation was erroneous or informal.
3730. That the judgment against the corporation was collusive.
3731. That the demand is invalid, the corporation having admitted it.
3732. That the debt was revived after being extinguished.
3733. That the debt was usurious.
3734. That the debt was *ultra vires*.
3735. That the debt has been satisfied in whole or in part.
3736. That the corporation has been discharged in bankruptcy.
3737. That the plaintiff purchased his demand against the corporation at a discount.

§ 3729. That the Judgment against the Corporation was Erroneous or Informal. — We have already had occasion to consider the question of the extent to which the judgment obtained by the creditor against the corporation is conclusive against the stockholder.[1] There is no theory which ascribes any effect at all to such a judgment, where, notwithstanding its rendition, the creditor is required to build up his claim over again against the stockholder. On the contrary, the stockholder cannot object that the judgment was *irregular* or *erroneous*,[2] — as, for instance, that the judgment was founded upon a demand which was in fact usurious,[3] especially where, as in Maine, the law of the forum allows him to prosecute a writ of error to reverse it.[4] So, in a *motion* for execution against a stockholder under the Missouri statute, an *informality* in entering the order for execution is of no avail to the stockholder, unless it be such as to render the order a nullity, — as, for instance, a failure to recite that the court found the issues in favor of the plaintiff.[5] For the same reason, it is obviously no defense to such a motion that there

[1] *Ante*, § 3392, *et seq.*

[2] Came *v.* Brigham, 39 Me. 35.

[3] Chaffin *v.* Cummings, 37 Me. 76.

[4] Merrill *v.* Suffolk Bank, 31 Me. 57; *s. c.* 50 Am. Dec. 649.

[5] Pickering *v.* Templeton, 2 Mo. App. 424, 430. The court approved the language of Waite, C. J., that "to make a record valid on its face, it is only necessary for it to appear that the court had jurisdiction of the subject-matter of the action and of the parties, and that a judgment had in fact been rendered. All else is form only." Maxwell *v.* Stewart, 22 Wall. (U. S.) 77. See, also, Grignon *v.* Astor, 2 How. (U. S.) 319; Martin *v.* McLean, 49 Mo. 361.

was a *variance* between the *name* of the corporation, as described in the judgment, and its actual name, as shown in the articles of association, unless the variance is substantial. Accordingly, where a judgment was rendered against the "Phœnix Brewery Co.," and the name of the corporation, as described in its articles of association, was the "Phœnix Brewery Co., St. Louis, Mo.," it was held that there was no substantial variance, since the words "St. Louis, Mo.," were merely descriptive, and no part of the corporate name, and might be rejected as surplusage.[1] A *misnomer* of a corporation, not pleaded in *abatement*, is disregarded, when the name has not been substantially mistaken.[2] And, of course, a judgment against one corporation would not lay a foundation for a proceeding against a stockholder in *another* corporation.

§ 3730. That the Judgment against the Corporation was Collusive. — One stockholder, being indebted to the corporation in a greater amount than the corporation is indebted to him, cannot, by transferring his right of action against the corporation to a third person, and by procuring the corporation to make a sham defense to an action brought by such third person, obtain a collusive judgment against the corporation, and make this judgment the foundation of a motion for an execution against another shareholder. In such a case, if the suit against the corporation had been prosecuted in the name of the real parties in interest, it would have been the duty of the managers of the corporation to plead, by way of counterclaim, the indebtedness of the real plaintiffs upon their stock subscriptions, and such real plaintiffs could not, in consequence of such indebtedness, have recovered a judgment against the corporation. The law will therefore not allow them to make such a judgment the foundation of a motion against other stockholders.[3]

[1] Schaeffer *v.* Phœnix Brewery Co., 4 Mo. App. 115, 119; *ante*, § 291, *et seq.*

[2] Burnham *v.* Savings Bank, 5 N. H. 446; International Ins. Co. *v.* Davenport, 57 Mo. 289.

[3] Franklin *v.* Menown, 10 Mo. App. 570; Menown *v.* Crawford, 10 Mo. App. 574.

§ 3731. That the Demand is Invalid, the Corporation having Admitted It. — A statute of Massachusetts,[1] providing that judgments against corporations shall not bind a member unless summons was left with him, and that one with whom summons is left may be admitted to defend in any such action, and if it shall appear that he is not liable, judgment for him shall be entered on the issues joined, does not authorize a stockholder to interpose a defense *to the demand*, if that be admitted by the corporation's *default*, but only a defense *to his liability*, — *i. e.*, on the question of membership.[2] This decision would seem to be contrary to sound principle. The stockholder thus impleaded with the corporation may be the only person interested in resisting the particular demand, and, as he is before the court, there would seem to be no legal difficulty in hearing any defense that he might choose to offer. We have already had occasion to note a view taken in Maine, which is quite contrary to this of Massachusetts, namely, that the stockholder may even maintain error on the judgment against the corporation;[3] but, as we have seen,[4] he is in general bound by it.

§ 3732. That the Debt was Revived after being Extinguished. — Where two corporations make a valid agreement whereby an indebtedness of one corporation is extinguished or assumed by the other, it is competent for such corporations, by mutual agreement duly made, to rescind such agreement, reinstate the liability of the corporation so discharged, and place the parties *in statu quo;* and the stockholders of the debtor corporation in such case will become personally liable for their respective proportionate shares of the liabilities so created or reinstated.[5] The theory of this decision is that, in the absence of fraud and collusion, whatever corporate action created a valid liability of the corporation, created, under the constitution and laws of California, a demand to which the individual liability of the stockholders attached.

[1] Mass. Stat. of 1851, ch. 315.

[2] Holyoke Bank *v.* Goodman &c. Co., 9 Cush. (Mass.) 576; recognized in Utley *v.* Union &c. Co., 11 Gray (Mass.), 139; Farnum *v.* Ballard-Vale &c., 12 Cush. (Mass.) 507. Compare Thayer *v.* Union Tool Co., 4 Gray (Mass.), 75.

[3] *Ante*, § 3406.

[4] *Ante*, § 3392, *et seq.*

[5] Borland *v.* Haven, 37 Fed. Rep. 394.

§ 3733. That the Debt was Usurious. — Where the bills of a bank were sold by its officers on a usurious contract, a subsequent *bona fide* purchaser of them was entitled to recover of the stockholders the full nominal value thereof, under a statute making the stockholders liable for the ultimate redemption of their respective proportions of the circulation, without any deduction on account of usury.[1]

§ 3734. That the Debt was Ultra Vires. — Whether the stockholder can, especially after the creditor has reduced his demand to a judgment against the corporation, defend against his liability on the ground that the corporation had no power to create the debt, — must be regarded as doubtful, in view of what has already been said concerning the conclusiveness of the judgment against the corporation for the purpose of charging the shareholder.[2] If the defense is simply that the contracting of the debt was *ultra vires* the agent of the company, then the case does not present so much difficulty; for, unless the stockholders in general meeting have promptly disaffirmed, and unless the benefits received under the *ultra vires* contract have been tendered back, then, upon well-settled principles obtaining in the law of agency, a *ratification* will be presumed.[3] But if the contract was *ultra vires* the corporation itself, — if the act done was one which the whole body of stockholders, voting unanimously in general meeting, were incompetent to do, because beyond their granted powers or prohibited to them by positive law, — then the question may present more difficulty. But the tendency manifestly is to hold corporations and their members estopped from urging defenses of this kind.[4] It has been held, in a case where a demand on which it was sought to make the stockholders of a national bank liable had been reduced to judgment against the corporation, that it was proper to re-examine the claim for the purpose of

[1] Grew *v.* Breed, 10 Met. (Mass.) 569.

[2] *Ante,* § 3392, *et seq.*

[3] *Post,* ch. 104, art. 4.

[4] Moss *v.* Averell, 10 N. Y. 449; Frost *v.* Saratoga Mutual Ins. Co., 5 Denio (N. Y.), 154; *s. c.* 49 Am. Dec. 234; Royal British Bank *v.* Turquand, 6 El. & Bl. 327; Re Athenæum Life Ins. Co., 4 Kay & J. 549.

ascertaining whether it was a demand of such a nature that the individual liability of the stockholders attached to it under the governing statute; and it was also held that the liability of such stockholders in *national banks* is restricted to such contracts, debts, and engagements as the bank has entered into in the *ordinary course of its business;* and, the debt under examination not being a debt of that kind, the stockholders were discharged.[1] But, in general, the conclusion must be that the stockholder will be able to set up against the validity of the demand of the creditor the defense of *ultra vires,* only where the nature of the proceeding, the terms of the governing statute, or the rules of procedure in the particular forum, allow him to contest the merits of that demand on any other ground.[2]

§ 3735. That the Debt has been Satisfied in Whole or in Part. — It is scarcely necessary to say that "whatever satisfies or extinguishes the debt as to the corporation, extinguishes also the liability of the stockholders, because the creditor can claim only one satisfaction of the debt."[3] So, whenever the debt of a corporation is satisfied in part,— as by the sale of property which has been mortgaged or pledged to secure it, this is *pro tanto* a discharge of the liability of the stockholders, and thereafter each one remains liable only for his proportion

[1] Schrader *v.* Manufacturers' Nat. Bank, 133 U. S. 67.

[2] See Schoonover *v.* Hinckley, 48 Iowa, 82, where it was held that the judgment against the corporation precluded the stockholder from setting up that the corporation did not owe the debt. The defense was successful on the ground of *ultra vires* in Sumner *v.* Marcy, 3 Woodb. & M. (U. S.) 105; in Planters' Bank *v.* Bivingsville &c. Co., 10 Rich. L. (S. C.) 95, where the question was merely that of the authority of the contracting agent; and in Athenæum Life Ins. Co. *v.* Pooley, 1 Giff. 102; *s. c.* affirmed on appeal, 5 Jur. (N. S.) 129, where debentures issued by a company were overthrown in equity after the commencement of winding-up proceedings; and in Cox *v.* Gould, 4 Blatchf. (U. S.) 341, where a stockholder successfully defended on the ground that the transaction was in fraud of a statute. But in Moss *v.* Averell, 10 N. Y. 449, it failed on the ground of *estoppel.*

[3] Young *v.* Rosenbaum, 39 Cal. 646, 654.

of the indebtedness of the corporation after the proper credits have been made.[1]

§ 3736. That the Corporation has been Discharged in Bankruptcy.— A discharge of the corporation under a bankrupt or insolvent law will operate to extinguish the debt as against the stockholders, and release them from a personal liability for it imposed by a constitutional or statutory provision.[2] But it will not release a personal liability denounced by a statute against the directors grounded on their own misprisions,— as a liability for debts contracted before the capital stock of the corporation has been paid in. The reason is, that such a liability is a direct liability from the directors to the creditor, and is not derivative through the corporation, and is consequently not affected by the discharge of the corporation from the obligation of paying the debt.[3]

§ 3737. That the Plaintiff Purchased His Demand against the Corporation at a Discount.—It is obviously no *defense* whatever on the part of the stockholder that the demand of the plaintiff against the corporation was purchased by him at a discount, even after the corporation was insolvent, provided the plaintiff stood in no fiduciary relation to the corporation; since a man may lawfully buy up dishonored claims at any price at which he can get them, and enforce them against their obligees, and avail himself of any security which may attach to them.[4] Accordingly, it has been held that one who *buys bank bills of a broker, at a discount,* under an agreement to keep them from circulation for a certain time, is entitled to the statute remedy against the stockholders for the full amount of the bills, unless he has *notice,* when he buys them, that they are improperly issued by the officers of the bank;

[1] San Jose Savings Bank *v.* Pharis, 58 Cal. 380.

[2] Mohr *v.* Minnesota Elevator Co., 40 Minn. 343; *s.c.* 41 N. W. Rep. 1074.

[3] First Nat. Bank *v.* Hingham Man. Co., 127 Mass. 563.

[4] Coquard *v.* Prendergast, 35 Mo. App. 237; Re Humber Iron Works Co., L. R. 8 Eq. 122; Walker *v.* Stillwell, U. S. Circ. Ct. East. Dist. Mo., cited in 2 Thomp. Stockh., § 394.

but such a sale to him by a broker is not evidence of such notice.[1] On the contrary, where the creditor proceeded in equity against the holder of stock which had been issued as a *bonus*, to compel him to pay up so much thereof as was necessary to satisfy the creditor's demand, and a demurrer was interposed to his complaint, it was held that it was not sufficient, but the complaint having disclosed that the plaintiff was merely the assignee of the demand,—it was necessary further to disclose what the plaintiff paid for it; and further, that the allegation that the plaintiff paid a *valuable consideration* for it was not a good disclosure, since the consideration might have been no more than one dollar.[2]

Article VI. Defenses Relating to the Conduct of the Creditor, Affecting His Demand.

Section
3740. That the plaintiff has taken out execution against the corporation.
3741. That the corporation has gone into bankruptcy, and that the creditor has received dividends.
3742. That the complainants have received a dividend from an assignee of the corporation.
3743. That the plaintiff failed to present his claim to the receiver.
3744. That the plaintiff has been secured by a pledge of the corporate property.
3745. That the plaintiff granted extensions of time to the corporation.
3746. That the plaintiff has compromised with other stockholders.
3747. That the plaintiff has released other stockholders.
3748. That the plaintiff took an assignment of debts due the corporation, and then compromised with the debtors.

§ 3740. That the Plaintiff has Taken out Execution against the Corporation.—In an action by a judgment creditor of a corporation against a subscriber to its stock who has not fully paid therefor, founded upon a statute which

[1] Grew *v.* Breed, 10 Met. (Mass.) 569.

[2] Hospes *v.* Northwestern Man. &c. Co., 48 Minn. 174, 199; *s. c.* 31 Am. St. Rep. 637; 15 L. R. A. 470; 45 Alb. L. J. 277; 36 Am. & Eng. Corp. Cas. 206; 50 N. W. Rep. 1117. The author quotes this decision with reserve, believing that on this and on other points it is over-reasoned and unsound, though possibly the right result may have been reached.

does not require such creditor to issue execution on his judgment against the corporation before bringing suit against the delinquent subscriber, the fact that he did so issue execution, and caused a seizure and sale thereon of personal property of the corporation in part satisfaction thereof, cannot prejudice him, since this is for the benefit of defendant.[1]

§ 3741. That the Corporation has Gone into Bankruptcy and that the Creditor has Received Dividends. — By section 21 of the late Bankrupt Act,[2] if a corporation or joint-stock company became bankrupt, no *discharge* could be granted to any such corporation or company, or to any officer or member thereof. In view of this provision, it has been held that the bankruptcy of a corporation did not dissolve it, nor did the proof, by a creditor, of his claim in the court of bankruptcy prevent him from recovering a judgment against a stockholder[3] for so much of his claim as remained unpaid, or against the corporation, for the purpose of charging its officers and stockholders therewith.[4] The same rule obtains under the Massachusetts statute of insolvency.[5] The principle underlying these decisions is that neither a court of law nor of equity has, by virtue of its general powers, jurisdiction to dissolve a corporation at the suit of a private person. The exercise of such a jurisdiction can only be justified by the existence of an express statute.[6] There was no provision in the late Bankrupt Act to the effect that an administration of the assets of a corporation in bankruptcy should have the effect to dissolve the corporation; and therefore it would not

[1] Grindle *v.* Stone, 78 Me. 176; *s. c.* 3 Atl. Rep. 183.

[2] Stat. U. S. 1867, ch. 176 (Rev. Stat., § 5122).

[3] Shellington *v.* Howland, 53 N. Y. 371; Birmingham Bank *v.* Keck, 55 How. Pr. 222.

[4] Chamberlin *v.* Huguenot Co., 118 Mass. 532; Folger *v.* Columbian Ins. Co., 99 Mass. 267; *s. c.* 96 Am. Dec. 747.

[5] Stat. Mass. 1851, ch. 327; Coburn *v.* Boston Papier Maché Co., 10 Gray (Mass.), 243; Johnson *v.* Somerville Dyeing Co., 15 Gray (Mass.), 216. Compare Morse *v.* Reed, 13 Met. (Mass.) 62; Barker *v.* Haskell, 9 Cush. (Mass.) 218; First Nat. Bank *v.* Hingham Man. Co., 127 Mass. 563.

[6] Folger *v.* Columbian Ins. Co., 99 Mass. 267, 276; *s. c.* 96 Am. Dec. 747.

be deemed to have such an effect, where to give it such an operation would prejudice the rights of creditors, although the contrary view would obtain where it was necessary to save their rights.[1] Where the operation of a State insolvency law is to discharge a corporation in like manner as an individual debtor, a release and a judgment discharging a corporation debtor releases and discharges the stockholders from a personal liability.[2]

§ 3742. That the Complainants have Received a Dividend from an Assignee of the Corporation.—The fact that the corporation has made an assignment of its assets for the benefit of its creditors, and that the complainants have received a dividend from the assignee,—in the particular case of sixty per cent,—thereby ratifying the assignment,—has been held no defense against their right to seek satisfaction of their claims thus reduced, by a legal or equitable proceeding against the assets of the bank or its stockholders.[3]

§ 3743. That the Plaintiff Failed to Present His Claim to the Receiver.—It has been held that where the assets of the corporation are placed in the hands of receivers, the holders of its bills, who do not present their claims to the receivers, cannot recover of stockholders the full amount thereof, but only the balance which they *would have* been entitled to recover, if they had proved their claim before the receivers, and obtained part payment.[4]

§ 3744. That the Plaintiff has been Secured by a Pledge of Corporate Property.—The doctrine that a shareholder, even in respect of a superadded individual liability, is *not a surety*,[5] has been pushed, in California, to the extent of holding that it is no bar to a suit against a stockholder, to recover a ratable proportion of the debts of the corporation, that the personal

[1] State Savings Asso. *v.* Kellogg, 52 Mo. 583.

[2] Mohr *v.* Minnesota Elevator Co., 40 Minn. 343; 41 N. W. Rep. 1074.

[3] City Bank *v.* Crossland, 65 Ga. 734.

[4] Grew *v.* Breed, 10 Met. (Mass.) 569.

[5] *Ante*, §§ 3001, 3025, 3077, 3094.

property of the corporation has been transferred to plaintiff as security for the indebtedness, and remains in his hands *in pledge*.[1] The court, after pointing out that it is of the nature of the contract of pledge to give the pledgee the right to retain the security until the debt is paid, proceeded to say: "It follows from this that if the plaintiff herein had sued the corporation upon its indebtedness, such action could have been maintained, though the pledged property remained in the possession of the plaintiff. This being true of the corporation, *a fortiori* is it true as to the defendant stockholder in such corporation."[2] But unless, under the governing statute, the liability of the stockholder is *primary*, like that of a *partner*, the sound view would seem to be that the creditor ought to be compelled to exhaust his remedy against any tangible assets of the corporation available to him, before proceeding against the stockholder;[3] and that, where he holds property of the corporation in pledge, he ought to foreclose his lien by a sale of the pledge, according to the terms of the contract, unless it gives him a mere right of retainer.

§ **3745. That the Plaintiff Granted Extensions of Time to the Corporation.** — This is no defense to the stockholder; for, although, as already seen,[4] the liability of a stockholder — especially a superadded statutory liability — is in some respects analogous to that of a *guarantor*, and especially in regard of the principle that it cannot be availed of so long as the corporation is able to respond,[5] yet, as was said by an eminent judge, "the analogy can be pushed no further. *Nullum simile quatuor pedibus currit.* The directors are the representatives of the stockholders in all their dealings with creditors. When they asked and accepted an extension, it was an act binding on the stockholders. It was their assent. Besides which, when the extension expired, the debt, being unpaid, was revived, and was then a debt newly contracted as

[1] Sonoma Valley Bank *v.* Hill, 59 Cal. 107.

[2] *Ibid.*, p. 111.

[3] *Ante*, § 3351.

[4] *Ante*, § 3086, *et seq.;* Patterson *v.* Wyomissing Man. Co., 40 Pa. St. 117.

[5] *Ante*, § 3351.

far as the then existing stockholders were concerned — and for which their liability under the statute then accrued. The ground upon which the surety is discharged by time given by the creditor on a binding contract without his assent is, that he is thereby deprived of his right to pay the debt and bring suit immediately against his principal. It is evident that such a remedy would have been entirely impracticable in a case like the present."[1] But under the construction placed upon other statutes, a *renewal* of a corporate debt renews the liability of directors and stockholders out of existence.[2]

§ 3746. That the Plaintiff has Compromised with Other Stockholders. — It is no defense to such an action that plaintiff has made a compromise with other stockholders, and has attempted to compromise with defendant, so long as his liability is not thereby increased.[3] Nor was it a defense, in a proceeding under a statute of Massachusetts[4] against directors and stockholders, that such a director or stockholder, having indorsed a note of the corporation and become *bankrupt*, received, on proceedings for a *composition*, a *release* from all liability as indorser.[5] So, it has been held that stockholders in a corporation are not released from liability for their unpaid stock subscriptions, under a call made by a judicial decree, by the fact that a subsequent decree provided that the stockholders paying a certain percentage within a specified time might be released, and that other stockholders were so released, where they did not avail themselves of such compromise, especially when such latter decree declared that the original decree should not be suspended in its operations.[6]

§ 3747. That the Plaintiff has Released Other Stockholders. — As the liability of each stockholder is several, it is no defense to an action by a creditor, or by a trustee of the

[1] Aultman's Appeal, 98 Pa. St. 505, 515, opinion by Sharswood, C. J.

[2] *Ante*, § 3117; *post*, § 4196.

[3] Hall *v.* Klinck, 25 S. C. 348; Howard *v.* Glenn, 85 Ga. 238; *s. c.* 11 S. E. Rep. 610; *s. c.* 21 Am. St. Rep. 156.

[4] Mass. Stat. 1870, ch. 224, § 42.

[5] First Nat. Bank *v.* Hingham Man. Co., 127 Mass. 563.

[6] Glenn *v.* McAllister, 46 Fed. Rep. 883.

corporation proceeding in right of its creditors, that the plaintiff has settled with and released other stockholders.[1]

§ 3748. That the Plaintiff Took an Assignment of Debts Due the Corporation, and then Compromised with the Debtors. — As already seen,[2] the creditor may *waive* his right to enforce the individual liability of the stockholder; and such a waiver seems to have arisen under the following circumstances: The notes of a corporation were given to two banks, and were secured by two classes of collateral, the first consisting of notes and obligations due to the corporation, and the second of notes, etc., made, indorsed, or guaranteed by individuals, members of the corporation. An indenture was made by the parties above named and A., assigning all the property of the corporation to A. for the payment of their debts to the banks. The banks were to use their discretion in collecting the notes of the first class, and to apply the proceeds to the payment of their demands against the corporation. The securities of the second class were to remain in the possession of the banks, and were not to be collected until the assignee had paid the property to the creditors. The banks afterwards *compromised* various debts due to the debtor corporation which were included in the first class above named. The amounts given up exceeded the balance due from the corporation to the banks. The compromises were made in good faith, and with the assent of the corporation, given by a vote; but those members who were bound on the securities of the second class did not attend the meeting, and had no legal notice of the proceedings. On a bill in equity, brought by the banks against these members, it was held that they were discharged from liability on their obligations by the conduct of the plaintiffs.[3]

ARTICLE VII. DEFENSES RELATING TO THE CONDUCT OF THE PROCEEDING TO CHARGE THE STOCKHOLDER.

SECTION
3751. That a receiver was improperly appointed.
3752. That the assessment was irregular.
3753. That the defendant did not have notice of the assessment.
3754. That the decree of assessment was collusive.
3755. That the decree of assessment authorized a compromise.

[1] Howard *v.* Glenn, 85 Ga. 238, 261; *s. c.* 21 Am. St. Rep. 156; 11 S. E. Rep. 610.

[2] *Ante*, § 3008.

[3] American Bank *v.* Baker, 4 Met. (Mass.) 164.

§ 3751. That the Receiver was Improperly Appointed. — In an action by a receiver to recover from a stockholder an assessment upon his unpaid stock, the latter cannot set up as a defense *fraud in procuring the appointment of the receiver*, or the claim that the corporation is not indebted; since these matters have been adjudicated in the action resulting in the appointment of the receiver.[1] So, the legality of an appointment of a receiver of a national bank cannot be inquired into by the stockholders, in an action upon an assessment made by the Comptroller of the Currency.[2]

§ 3752. That the Assessment was Irregular. — It may be stated as a general rule, applicable alike to suits brought by trustees of an insolvent corporation appointed under statute,[3] and to assignees in bankruptcy,[4] and to the Comptroller of the Currency under the National Banking Act,[5] that objections to the mode in which such trustees or assignees have proceeded in making assessments upon the unpaid shares of stockholders must be made in the court having jurisdiction of the proceedings in chief, and cannot be made for the first time by the shareholder when sued by the trustees or assignees to recover the amount so assessed. If the assessors had jurisdiction to make the assessment, errors committed by them in assessing stock not liable to assessment, or in determining the amount of the assessment, should be corrected by an application to the court having charge of the bankruptcy or winding-up proceeding.[6] But where the trustees have attempted to make an assessment upon stockholders without first having disposed, or attempted to dispose, of the property of the company, or to collect its debts, this is an objection which goes to the juris-

[1] Schoonover *v.* Hinckley, 48 Iowa, 82. See for analogy, Stewart *v.* Lay, 45 Iowa, 604.

[2] Young *v.* Wempe, 46 Fed. Rep. 354.

[3] As in Hurd *v.* Tallman, 60 Barb. (N. Y.) 272.

[4] As in Sanger *v.* Upton, 91 U. S. 56; Payson *v.* Stoever, 2 Dill. (U. S.) 427.

[5] Kennedy *v.* Gibson, 8 Wall. (U. S.) 498, 505; Cadle *v.* Baker, 20 Wall. (U. S.) 650.

[6] Hurd *v.* Tallman, 60 Barb. (N.Y.) 272; Payson *v.* Stoever, 2 Dill. (U. S.) 427; Upton *v.* Hansbrough, 5 Chi. Leg. N. 242; *s. c.* 3 Biss. (U. S.) 417; Sanger *v.* Upton, 91 U. S. 56.

diction of the trustees to make the assessment at all.[1] Pursuing the terms of a statute, it was accordingly held that where trustees of an insolvent corporation are acting without any direction of court, but merely under the powers conferred by the act, they must defer any assessment upon stockholders till such time as they have complied with the provisions of the act in regard to disposing of the property and collecting the liabilities, in order that it may be seen whether any, and if any, what, assessment "is necessary."[2]

§ 3753. That the Defendant did not Have Notice of the Assessment. — The right of the shareholder to notice of the assessment has been considered in a former chapter, where it is seen that some jurisdictions dispense with the requirement of notice.[3] Under any theory, the stockholder will be presumed to have had knowledge of such assessments as were made while he was a *director*, and cannot, even as against the corporation, defend an action to recover assessments on the ground that he did not have such knowledge.[4]

§ 3754. That the Decree of the Assessment was Collusive. In an action by the trustee, appointed by a court to wind up a corporation, to recover a judicial assessment, it is no defense on the part of the shareholder that the decree, — although obtained in a *foreign State*, which established the indebtedness of the corporation, directed the assessment, and appointed the plaintiff as a trustee to collect the same, — was procured by collusion with one of the directors of the company.[5] The reason is that, where a judgment is recovered in one State and is thereafter made the foundation of an action in another State, the action cannot be defended on the ground of fraud in the concoction of the judgment. The

[1] Hurd *v.* Tallman, 60 Barb. (N. Y.) 272.

[2] *Ibid.* Compare Walker *v.* Crain, 17 Barb. (N. Y.) 119; Matter of Reciprocity Bank, 22 N. Y. 9; Story *v.* Furman, 25 N. Y. 214; Greenwood's case, 3 De Gex, M. & G. 459.

[3] *Ante*, §§ 1703, 1748.

[4] Spellier Electric Time Co. *v.* Geiger, 147 Pa. St. 399; *s. c.* 1 Pa. Adv. Rep. 214; 23 Atl. Rep. 547.

[5] Hambleton *v.* Glenn, 72 Md. 331, 343.

judgment cannot thus be overturned in a collateral proceeding, but the remedy of the defendant, if any, is to impeach it by a direct proceeding in equity in the jurisdiction in which it was recovered.[1] And, where the stockholder thus sued had previously filed a petition in the court pronouncing the decree of assessment, to *review* that decree, — it was held that he was now estopped from setting up any matter as a defense to the action which he might have included in his former *bill of review*, on the principle that there must be somewhere an end to litigation.[2]

§ 3755. That the Decree of Assessment Authorized a Compromise. — In an action by the trustee appointed by a court, against a stockholder, to recover from him his proportion of an assessment ordered by the court upon the shares of the stockholders, a plea that the decree provided that if the stockholders would pay a certain per cent. of their subscriptions by a given time, this would be sufficient to satisfy the indebtedness of the corporation, is bad, if it fails to allege that the defendant paid, or offered to pay, that per cent.[3]

Article VIII. Other Defenses.

Section
3758. That other creditors are entitled to priority of demand.
3759. That a prior judgment has been rendered against the defendant.
3760. That a prior suit is pending.
3761. That the assets of the corporation are unappropriated.
3762. That there is a solvent judgment debtor other than the corporation.
3763. That the receiver or assignee has been guilty of misconduct in dealing with the assets.

[1] Christmas *v.* Russell, 5 Wall. (U. S.) 290; Maxwell *v.* Stewart, 22 Wall. (U. S.) 77; Hanley *v.* Donoghue, 116 U. S. 1; Hambleton *v.* Glenn, 72 Md. 331, 348 (citing the preceding cases). On this principle it was held by all the courts in which actions were brought against stockholders by the trustee appointed by a Virginia court in the litigation known as "*the Glenn cases*," that the decree was conclusive except as to defenses which pertained especially to the relation of the defendant to the insolvent corporation as a stockholder. See especially Hawkins *v.* Glenn, 131 U. S. 319, 332; Glenn *v.* Liggett, 135 U. S. 533; Hambleton *v.* Glenn (2d case), 72 Md. 351; Glenn *v.* Williams, 60 Md. 93.

[2] Hambleton *v.* Glenn (2d case), 72 Md. 351; citing Sugg *v.* Thornton, 132 U. S. 524, 529.

[3] Howard *v.* Glenn, 85 Ga. 238; *s. c.* 21 Am. St. Rep. 156; 11 S. E. Rep. 610.

§ 3758. That Other Creditors are Entitled to Priority of Demand.—Where, in a general law under which a bank was organized, it was provided that the bill-holders of the bank should be entitled to a *priority* of payment, it was held that that fact alone could not avail a stockholder made individually liable for the debts of the bank, in a suit against him by the holder of a draft issued by the bank.[1]

§ 3759. That a Prior Judgment has been Rendered against the Defendant.—If a judgment has already been rendered against a stockholder, in a suit brought by or on behalf of a creditor or creditors, to the extent of his liability, he may plead such judgment as a defense to a subsequent action brought to charge him in respect of the same liability,[2] although he has not paid it.[3] In Missouri, where a view has been taken contrary to the doctrine of Maine, stated in the next section, in an action against a stockholder, an answer that another creditor has sued the stockholder and obtained judgment, execution, and payment to the full amount of the liability of such stockholder, is a good plea in bar, although the suit in which the judgment was rendered was begun *after* that in which the answer was made.[4]

§ 3760. That a Prior Suit is Pending.—Whether the plea of a *prior action pending* can avail a shareholder, when sued in respect of his individual liability, is pretty clearly settled in the negative;[5] and for the reason that although, as has been declared in Maine,[6] a pending suit operates as a *lien* or *charge*, to the extent of the amount therein claimed, upon the amount for which the defendant stockholder is liable, yet this lien or charge does not become fixed unless the suit is prosecuted to judgment,—an event which may never happen. Much, therefore, as the law discourages a multiplicity of suits, it is

[1] Paine *v.* Stewart, 33 Conn. 516. See *post*, § 3838, *et seq.*

[2] Woodruff & Beach Iron Works *v.* Chittenden, 4 Bosw. (N. Y.) 406.

[3] Bittner *v.* Lee, 25 Mo. App. 559.

[4] State Sav. Asso. *v.* Kellogg, 52 Mo. 583; *s. c.* 4 Cent. L. J. 332; *post*, § 3840.

[5] *Post*, § 3840.

[6] *Post*, § 3839.

difficult to see how the pendency of one action can be successfully pleaded in bar of another. A court, however, might, and in some cases probably would, stay proceedings in the later suit in order to await the result of the earlier, unless it should appear that the earlier was collusive, or was not being diligently prosecuted. It was no defense to an action against a stockholder to enforce his liability under a statute of Maine, that other creditors had moved against him before the plaintiff in that suit, and had laid the foundation for his liability to them. Nor was it enough to show that suits had been instituted and were pending on such prior claims. The liability must be legally established and fixed, to an amount which exhausts it, and this must be *bona fide*, in order to bar the prosecution of other claims.[1]

§ 3761. That the Assets of the Corporation are Unappropriated. — If the corporation has other assets capable of being called in, sufficient to satisfy all its creditors, it is a fair inference from what has already been stated[2] that its shareholders ought not to be charged with its debts, whether in respect of unpaid stock or of a superadded statutory liability. In other words, the liability of the shareholder being *secondary*, he cannot be proceeded against while the creditor has an adequate remedy against the corporation. But where a stockholder, proceeded against at law, sets up such a defense, he must, in his plea, point out specifically the property of the corporation which remains available for the satisfaction of creditors. A plea that the plaintiff was not entitled to his action at the time it was brought, because the bank was not at the time insolvent, but had property and assets which had not been exhausted, has been held bad for uncertainty;[3] and even then, under other theories of equity procedure, such a defense will be unavailable, because the return of an execution *nulla bona* will be held conclusive.[4]

[1] Ingalls *v.* Cole, 47 Me. 530.

[2] *Ante*, § 3351.

[3] Lane *v.* Morris, 8 Ga. 468, 473.

[4] *Ante*, § 3363; Baines *v.* Babcock, 95 Cal. 581; *s. c.* 29 Am. St. Rep. 158; 30 Pac. Rep. 776; Baines *v.* Story (Cal.), 30 Pac. Rep. 777.

The Supreme Court of Iowa has taken the view that where a *receiver* of an insolvent banking company brings action at law against one of its stockholders to recover in respect of the amount for which the latter is liable on account of payments not made on his stock, and also under a statute making him further liable to the extent of the par value of his stock, the latter cannot defend by showing that there is a large amount of uncollected claims in the hands of the plaintiff, the proper assets of the corporation, against solvent persons, adequate to pay all its indebtedness without calling upon its stockholders, which the plaintiff refuses and neglects to collect (after request) and to apply to the payment of such debts.[1] So, it is held not error, in an action to enforce against a stockholder a judgment recovered against the corporation, to refuse to allow the stockholder to prove that the corporation has property outside the county within which the judgment was obtained, out of which the same might be satisfied,[2] — the theory being that the *return of the sheriff* on an execution against the corporation, issued to the proper county, is *conclusive* between the parties.[3]

§ **3762. That there is a Solvent Judgment Debtor Other than the Corporation.** — Suppose the creditor has recovered a judgment jointly against the corporation and another solvent party, can he, in case he fails to obtain satisfaction out of the corporation, ignore the other judgment defendant and proceed to enforce the individual liability of the stockholders? It has been held that he cannot;[4] but it is to be observed that this places the stockholders substantially in the position of *sureties*, who are entitled to be exonerated as long as there is any principal debtor from whom the creditor can have satisfaction.[5]

[1] Stewart *v.* Lay, 45 Iowa, 604.

[2] Ripley *v.* Evans, 87 Mich. 217; *s. c.* 10 Rail. & Corp. L. J. 250; 49 N. W. Rep. 504.

[3] *Ante*, § 3363.

[4] Burch *v.* Taylor, 1 Wash. 245; *s. c.* 24 Pac. Rep. 438; Burch *v.* Glover, 1 Wash. 250; *s. c.* 24 Pac. Rep. 439; Burch *v.* Moore, 1 Wash. 249; *s. c.* 24 Pac. Rep. 439.

[5] *Ante*, § 3351.

§ 3763. That the Receiver or Assignee has been Guilty of Misconduct in Dealing with the Assets. — Nor would it be any defense to show that the receiver, during the time he had been acting as such, had been speculating in the indebtedness of the bank; had purchased a large amount thereof at fifty cents on the dollar; had appropriated the assets of the bank to take up the same at the face value thereof, pretending that the same was an indebtedness of the bank; that he was endeavoring fraudulently to collect from the stockholders the unpaid amount of their subscriptions, to pay off such illegal indebtedness so held by him and the officers of the bank, all of which had been purchased by them at fifty cents on the dollar, with full knowledge that the same was illegal.[1] So, it has been held that if a bank whose charter makes the stockholders personally liable, makes an assignment, which is ratified by the Legislature, of sufficient assets to secure its circulation, and those assets are afterwards wasted, so that, on a *fieri facias* against the assignee, in favor of a billholder, *nulla bona* is returned, the stockholders are not discharged; but the billholder may have immediate recourse to them for payment.[2]

[1] Stewart *v.* Lay. 45 Iowa, 604.

[2] Robinson *v.* Lane, 19 Ga. 337.

CHAPTER LXIX.

LIMITATION OF ACTIONS BY OR ON BEHALF OF CREDITORS.

ART. I. GENERAL PRINCIPLES. §§ 3766–3775.
II. WHEN SUCH STATUTES BEGIN TO RUN. §§ 3779–3782.

ARTICLE I. GENERAL PRINCIPLES.

SECTION
3766. Preliminary statement.
3767. Statutes of limitation applicable to penalties.
3768. Statutes exonerating stockholders unless action brought against corporation within a given time.
3769. In the case of notes which have been renewed.
3770. Where the creditor sues to sequester unpaid balances.
3771. Filing of general creditors' bill arrests the running of the statute as to creditors subsequently joining.
3772. Prescription under the code of Louisiana.
3773. Delay and laches.
3774. Presumption of payment from lapse of time.
3775. Why a judicial call does not rebut this presumption of payment.

§ **3766. Preliminary Statement.**—In a former chapter[1] it was attempted to consider the effect of statutes of limitation upon actions brought by the corporation against the stockholder to enforce assessments; but the question is involved to such an extent, in actions brought by or on behalf of creditors against stockholders, that no attempt was made to separate them. It is now proposed to consider some matters, specially relating to actions by or on behalf of creditors, which were not considered in that chapter; and this chapter should be read in connection with that.

§ **3767. Statutes of Limitation Applicable to Penalties.**—The question what statutes making stockholders, directors,

[1] *Ante*, § 1986, *et seq.*

and other officers of corporations, liable to its creditors, are *penal* in their nature, and what *remedial*, has already been considered.[1] The question may have a bearing, in particular cases, upon the application of statutes of limitation; since in most of the States a shorter period of limitation is prescribed for actions to recover penalties than for actions to enforce contracts. Upon this subject it was held, in a leading case in New York, that an action against stockholders, under a statute which makes them individually liable for the corporate debts, is not within the operation of a statute of limitations which restricts the commencing of an action "upon a statute *for a forfeiture* or cause, the benefit and suit whereof is limited to the party aggrieved," to three years; but it is rather to be deemed within that provision of the statute which regulates the bringing of "any action founded on *contract*, express or implied," and the statute of *six years*, therefore, applies.[2] So, a statute of Nebraska,[3] which makes stockholders in a corporation liable for debts contracted by the corporation while its officers are in default in publishing an *annual notice* stating the amount of all the existing debts of the corporation, is *quasi* penal, but is *not a penalty*,—the evident purpose being to secure the rights of creditors; so that an action to secure the rights of creditors and to recover such debts is not barred by the statute of limitations of *one year*.[4]

§ 3768. Statutes Exonerating Stockholders unless Action Brought against Corporation within a Given Time.—Statutes exist in some of the States limiting not only the *character of the debts* for which stockholders shall be liable to creditors,[5] but also the *period* within which an action must be commenced by the creditor against the corporation if he would thereafter charge the stockholders. Of these, the following statute of Missouri may be quoted as an example: "No stockholder shall

[1] *Ante*, § 3013, *et seq.*

[2] Corning *v.* McCullough, 1 N. Y. 47; *s. c.* 49 Am. Dec. 287.

[3] Comp. Stat. Neb., ch. 16, § 136.

[4] Howell *v.* Roberts, 29 Neb. 483; *s. c.* 45 N. W. Rep. 923; Coy *v.* Jones, 30 Neb. 798; *s. c.* 10 L. R. A. 658; 1 Neb. L. J. 440; 47 N. W. Rep. 208.

[5] *Ante*, § 3110, *et seq.*

be personally liable for the payment of any debt contracted by any company formed under this charter which is not to be paid within one year from the time the debt is contracted, nor unless a suit for the collection of such debt shall be brought against such company within one year after the debt shall become due."[1] The Legislature has power to pass such statutes, and their validity cannot be questioned in the courts, unless the period of limitation is so short that the courts are able to say that it is *unreasonable*.[2] Within this principle, it has been held that the statute above quoted is not unreasonable.[3]

§ 3769. In the Case of Notes Which have been Renewed. In the case of a liability in respect of an unpaid subscription, or the ordinary superadded statutory liability, the *general rule* is, that whatever demand, founded in contract, is enforceable against the corporation, is enforceable against the stockholders. Under this theory, where the debt is renewed by the giving of new notes in exchange for old ones, the statute cannot begin to run in favor of the stockholder, under any view, until the maturity of the notes given in renewal. It is said to be the settled rule in Maine that an acceptance of negotiable paper for a debt, and a receipt given in exchange for the debt, are an *extinguishment of the original liability* of the debtor, unless the parties did not so intend it. From this the conclusion has been drawn that when the debt of a corporation is settled by its negotiable note, and that note, when due, is taken up by another note, and nothing appears to show the intention of the parties, the date of the second note must be treated as the time when the indebtedness of the corporation accrued, so far as relates to the liability of the stockholder.[4] Where the statute is of a class already considered,[5] imposing a *limitation upon the debt* for which the stockholders shall be liable, by providing that they shall not be liable for

[1] 1 Wagn. Stat. 336, § 13.

[2] *Ante*, § 1994.

[3] Adamson *v.* Davis, 47 Mo. 268.

[4] Milliken *v.* Whitehouse, 49 Me. 527. As to this subject in other relations, see *ante*, §§ 2017, 3117, 3187; *post*, § 4196.

[5] *Ante*, § 3768.

debts which were *not to be paid within one year* from the time of being contracted, then the question frequently arises, whether the *renewing* of the debt by giving new notes is a prolongation of it beyond the period of one year, such as takes it out of the statute and releases the stockholders, or is a *payment* of it such as makes the new note a new contract. The Supreme Court of South Carolina, adopting a view analogous to that held by some other courts,[1] have held that the *burden* is upon the creditor to show that payment, and not merely renewal or prolongation, was intended; and, the creditor not having shown that the express contract was that the new note was to be given in payment, the court held that the transaction operated to create a debt extending beyond the period of one year, so as to exempt the stockholders from liability under the statute.[2] The conclusion is believed, by the writer, to be unsound, and the reason in support of it mere casuistry. Every person of ordinary experience knows that when business men renew debts, by the giving of new notes in the place of old ones, they do not stop to debate or consider whether they are prolonging the old debt or making a new contract. They are doing both — they are paying the old debt in a sense, and renewing it in a sense; they are keeping alive the old contract in a sense, and they are making a new contract in another sense; and the rule is a gross piece of injustice which turns the indulgence of the creditor of the corporation into a destruction of the security which he has in the personal liability of the men who compose the corporation, and for whose benefit the credit was extended to it by him.

§ 3770. Where the Creditor Sues to Sequester Unpaid Balances.—In Missouri, creditors have two statutory remedies against stockholders. One is by a *motion* for execution under a statute already considered,[3] and the other is by a direct

[1] Compare *ante*, §§ 2017, 3117, 3187, and *post*, § 4196; Griffith *v.* Green, 59 Hun (N. Y.), 619; *mem.* 37 N. Y. St. Rep. 705; 13 N. Y. Supp. 470; Parrott *v.* Colby, 6 Hun (N. Y.), 55.

[2] Union Bank *v.* Wando Mining &c. Co., 17 S. C. 339.

[3] *Ante*, § 3602, *et seq.*

action in the nature of an action at law. These remedies are not exclusive, but the creditor may, in addition thereto, maintain a *creditor's bill in equity* to subject what remains due from the stockholders to the corporation in respect of their several holdings, for there is in that State no superadded individual liability. As in other cases in that State,[1] the statute of limitations does not begin to run against such a creditor's suit until the creditor's claim has matured in such a sense that he could have brought his action against the corporation. When, therefore, the president of a banking corporation, upon its becoming insolvent, procured an extension from its creditors by an arrangement under which he issued *scrip* to them, payable in three years, secured by a mortgage upon his own property, and the circumstances were such that the court concluded that he had power so to act for the corporation, or, at least, that his action was ratified by it,—it held that the statute did not begin to run, against a creditor's suit in equity, until the date of the maturity of this scrip.[2] We have had occasion to refer to the general rule of equity procedure which withholds the aid of equity from a creditor until he has *exhausted his remedy at law* by recovering a judgment which, after due diligence, remains unsatisfied.[3] The recovery of a judgment at law being, under this theory, a *condition precedent* to the right of a creditor to invoke the aid of equity, it is a safe conclusion that no statute of limitations will be allowed to run against his suit in equity from an earlier date than the date of the recovery of his judgment at law,[4] though he may nevertheless be repelled on the ground of *laches*.[5] This is in harmony with a holding of the St. Louis Court of Appeals, to the effect that a creditor's action against the stockholder may be brought at any time within five years after the maturity of the debt, though more than five years have elapsed since the dissolution of the corporation.[6] In Iowa, in order to bar an

[1] *Ante*, § 2011.

[2] Washington Sav. Bank *v.* Butchers' &c. Bank, 107 Mo. 133; *s. c.* 28 Am. St. Rep. 405.

[3] *Ante*, § 3351, *et seq.*

[4] Powell *v.* Oregonian R. Co., 38 Fed. Rep. 187.

[5] *Post*, § 3773.

[6] McGinnis *v.* Kortkamp, 24 Mo. App. 378.

action against a stockholder of a corporation to subject the unpaid balance due on his stock to the satisfaction of a judgment obtained against the corporation on its note given within five years, it is necessary, not only to show that the note was given for a debt which accrued more than five years previous to the commencement of the action, but that, at the date of the note, the indebtedness of the corporation could not have been collected from the corporation.[1] This is in conformity with a previous decision of the same court to the effect that the right of action by a corporation creditor against a stockholder, to the extent of his unpaid balance due on stock, accrues when it is clear that the corporation has no property from which the claim may be collected, and not from the time of recovery of judgment against the corporation.[2] The theory is, that such a *judgment* is not necessary, as a *condition precedent*, to the right of action by the creditor against the stockholder, though it may be a necessary instrument of *evidence* in such an action, to determine the measure of the recovery.[3]

§ 3771. Filing of General Creditors' Bill Arrests the Running of the Statute as to Creditors Subsequently Joining. — It was held in the English Court of Appeal, by Lord Justice Mellish, that, in a case where the assets of a debtor are to be divided amongst his creditors, whether in bankruptcy or in insolvency, or under a trust for creditors, or under a decree of a court of chancery in an administration suit, "the rule is, that everybody who had a subsisting claim at the time of the adjudication, the insolvency, the creation of the trust for creditors, or the administration decree, as the case may be, is entitled to participate in the assets, and that the statute of limitations does not run against this claim; but as long as assets remain unadministered, he is at liberty to come in and prove his claim, not disturbing any former dividend."[4]

[1] Tama Water-Power Co. *v.* Hopkins, 79 Iowa, 653; *s. c.* 44 N. W. Rep. 797.

[2] First Nat. Bank *v.* Greene, 64 Iowa, 445.

[3] *Ibid.*

[4] Joint-Stock Discount Company's Claim, L. R. 7 Ch. 646. The same principle is laid down in 1 Daniell's Ch. Pr., 4th ed., 643.

Quoting with approval this statement of doctrine, the Supreme Court of the United States have held that, where a general creditors' bill is filed against an insolvent *national bank* and its stockholders, the bill necessarily stands as a bill in behalf of the complainant, and all the other creditors who may come in and join them, whether it recites that it is so brought or not; that the filing of such a bill stops the running of the statute of limitations, not only in respect of the demands of the creditor filing the bill, but in respect of the demands of all other creditors.[1] The theory of this holding is, that the rights of all creditors, and the defenses against them, are to be determined by the state of things existing at the time of the *commencement of the suit*, and not at the time when they may come in and prove up their respective claims. The doctrine was thus explained in the opinion of the court given by Mr. Justice Matthews: "When any creditor appeared, during the progress of the cause, to set up and establish his claim, it was necessary for him to prove that, at the time of filing the bill, he was a creditor of the bank. Any defense which existed at that time to his claim, either to diminish or defeat it, might be interposed either before the master, or, on the hearing, to the court. The creditor having established his claim, became entitled to the benefit of the proceeding, as virtually a party complainant from the beginning, and the time that had elapsed from the filing of the bill to the proof of his claim would not be counted as a part of the time relied on to bar the creditor's right to sue the stockholders. In other words, if he proves himself to be a creditor with a valid claim against the bank, he becomes a complainant *by relation* to the time of the filing of the bill."[2]

§ 3772. Prescription under the Code of Louisiana.— Under the code of Louisiana, prescription does not begin to run in favor of the stockholder until there has been a *call*,

[1] Richmond *v.* Irons, 121 U. S. 27, 52; so held in Irons *v.* Manufacturers' Bank, 27 Fed. Rep. 591.

[2] Richmond *v.* Irons, 121 U. S. 27, 52.

and then his liability is not barred until the lapse of a period of ten years. Where the indebtedness of the stockholder to the corporation is secured by a pledge of his shares, the possession by the corporation of the pledgee is a constant recognition of the debt, on the part of the stockholder, which prevents prescription from running at all. It is said by Burmudez, J., citing many authorities: "It is not the contract or act of pledge that interrupts prescription, but it is the *detention* of the thing pledged. Such *possession* is a constant renunciation of prescription every instant that it begins to run." [1]

§ **3773. Delay and Laches.**—The effect of delay on the part of the creditor in pursuing his remedy, as against the corporation, and afterwards against the stockholder, will depend upon whether the creditor pursues his remedy against the stockholder in the legal or in the equitable forum. If he brings his action *at law*, or pursues a strictly statutory remedy, it may be assumed that he will not be prejudiced by his delay, so long as he keeps within the statute of limitations or avoids the presumption of payment from lapse of time. A court of *equity* will not aid creditors of an insolvent corporation to enforce satisfaction of their demands against its shareholders, where they have suffered a number of years to elapse, during which important changes have taken place, without attempting to enforce their rights.[2] The general reason which supports the equitable doctrine of laches is, that after the lapse of a considerable time parties naturally and justly act upon the assumption that a state of things then existing will not be disturbed. To allow that state of things thereafter to be disturbed would disappoint their just expectations and impair the rights acquired in consequence of them. The principal reason for applying the doctrine in favor of stockholders is, that where the creditor proceeds seasonably, the right of *subrogation* which

[1] Citizens' Bank *v.* Hyams, 42 La. Ann. 729, 733; *s. c.* 7 South. Rep. 700.

[2] Gilmore *v.* Bank of Cincinnati, 8 Ohio, 62, 71; Burke *v.* Smith, 16 Wall. (U. S.) 390; Searcy *v.* Little Rock &c. R. Co., 5 Dill. (U. S.) 348.

the stockholder may have against the unexhausted but undiscovered assets of the corporation, and the right of *contribution* which he may have against other solvent stockholders, may be beneficial to him; whereas these rights may be impaired or lost after a considerable lapse of time. At the same time the subject is one which addresses itself to the conscience of the chancellor in such a sense that no definite rule can be stated with reference to it. What will be such a delay as will repel the creditor from the doors of a court of equity will depend largely upon the circumstances attending each particular case. In one case *a delay of twelve years* was held sufficient;[1] and in another case where there had been a delay of nearly *seven years* after the release of the stockholders, which was the subject of the complaint, during which time the company had become practically dissolved, it was held that the creditors ought not, for this reason (if for no other), to succeed in equity.[2] In like manner, where the creditor recovered his judgment in 1857 and his execution was returned *nulla bona* in 1858, and his creditor's suit in equity was not brought until *ten years* thereafter, it was held that he ought to be precluded by his laches.[3] On the other hand where, in an action to charge the *trustees* of a corporation with personal liability for a debt of the company, the defendants answered that, at the time the debt matured, and for a long time afterwards, the corporation was solvent, and its stockholders severally and individually liable for all its debts, by reason of the non-payment of its capital stock; that the plaintiff neglected to institute suit for *two years;* that, by such neglect, the plaintiff released and discharged the stockholders from personal liability; that no notice was ever given to defendants of the plaintiff's claim, nor had the defendants any opportunity of being subrogated to the rights and remedies of the plaintiff against the corporation while solvent, nor against the stockholders before they were released as above stated,—on demurrer to the answer, it

[1] Gilmore *v.* Bank of Cincinnati, 8 Ohio, 62, 71.

[2] Searcy *v.* Little Rock &c. R. Co., 5 Dill. (U. S.) 348.

[3] Burke *v.* Smith, 16 Wall. (U. S.) 390.

was held that these facts constituted no defense to the action.[1] In like manner it has been held that a stockholder is not released from his liability for a debt of the corporation by the fact that its property was sequestrated, a receiver appointed, and its officers enjoined from doing business *four years previously*, there having been no judgment of dissolution.[2]

§ 3774. Presumption of Payment from Lapse of Time.— The doctrine of a presumption of payment from a great lapse of time — generally a period of *twenty years* — bears only a remote analogy to the equitable doctrine of laches, and is more nearly allied to the policy which dictates the enacting of statutes of limitation. The doctrine of *laches*, as already seen, is a meritorious defense, addressing itself to the reason and conscience of the chancellor in view of the facts of each particular case. But the doctrine of the presumption of payment from lapse of time rests upon a theory of public policy, and, like the statutes of limitation, it is applied arbitrarily and wholly without reference to the merits, and even where the evidence shows that the debt has not in fact been paid. It is merely a rule of public policy, and is in fact *a judicial statute of limitations.* The doctrine applies both at law and in equity. In cases where no statutes of limitation are applicable, it operates to mature the title of the possessor of personal property;[3] to bar proceedings by a distributee to compel an administrator to settle;[4] to bar the right of entry of an infant, though the entire period of adverse holding was during his infancy;[5] to put an end to the rights of a mortgagee who has taken no steps to assert them;[6] to bar a proceeding in equity to compel a settlement by a trustee, where, during a period of

[1] Merchants' Bank *v.* Bliss, 13 Abb. Pr. (N. Y.) 225.

[2] Hollingshead *v.* Woodward, 35 Hun (N. Y.), 410. This case was reversed, but on another ground, in 107 N. Y. 96.

[3] McArthur *v.* Carrie, 32 Ala. 75, 88; *s. c.* 70 Am. Dec. 529.

[4] Harrison *v.* Heflin, 54 Ala. 552; Greenlees *v.* Greenlees, 62 Ala. 330.

[5] Woodstock Iron Co. *v.* Roberts, 87 Ala. 436.

[6] Goodwyn *v.* Baldwin, 59 Ala. 127.

twenty years, there has been no recognition of the trust.[1] In short, this rule of repose "has been declared applicable to all kinds of debts and pecuniary obligations, including judgments, bonds, and mortgages, embracing also fiduciary debts of every character due from trustees to *cestuis que trust.*"[2] That it is a fixed and arbitrary rule, proceeding in obedience to general rules of public policy, and often in the face of justice in particular cases, will appear from a decision in which it was decided that the intervention of the Civil War, suspending even the statutes of limitations, would not arrest the *running*, if it could be so called, of this judicial statute of limitations. "This," said the court, "may acquit suitors from the imputation of *laches;* but the presumption rests, not only on the want of diligence in asserting rights, but on the higher ground, that it is necessary to suppress frauds, to avoid long dormant claims, which, it has been said, have often more of cruelty than justice in them; that it conduces to the peace of society, and the happiness of families, and relieves courts from the necessity of adjudicating rights so obscured by the lapse of time and the accidents of life that the attainment of truth and justice is next to impossible."[3] There was a recognition of the application of this presumption to the case of an action against a stockholder to enforce his unpaid subscription, by a trustee in charge of the assets of the cor-

[1] McCarthy *v.* McCarthy, 74 Ala. 546; so stated in Philippi *v.* Philippe, 115 U. S. 151, 159; citing Elmendorf *v.* Taylor, 10 Wheat. (U. S.) 152; Bowman *v.* Wathen, 1 How. (U. S.) 189; Wagner *v.* Baird, 7 How. (U. S.) 234; Kane *v.* Bloodgood, 7 Johns. Ch. (N. Y.) 90; *s. c.* 11 Am. Dec. 417; Hovenden *v.* Annesley, 2 Sch. & Lef. 607, 636; Cholmondely *v.* Clinton, 1 Jac. & Walk. 1, 138.

[2] Garrett *v.* Garrett, 69 Ala. 429, 430.

[3] Harrison *v.* Heflin, 54 Ala. 552, 563. In this case there is a learned and able exposition of the doctrine by Brickell, C. J. These decisions are collected from the excellent opinion of the late Mr. Justice Clopton in the case of Semple *v.* Glenn, 91 Ala. 245, 261; *s. c.* 24 Am. St. Rep. 894, *et seq.* Decisions from other jurisdictions, English and American, might be greatly multiplied in illustration of a rule generally well understood by the profession; but this would involve too great a digression from the plan of the present work. See Husky *v.* Maples, 2 Coldw. (Tenn.) 25; *s. c.* 88 Am. Dec. 588, note 590, and cases there cited.

poration, in the language of Mr. Chief Justice Fuller, in one of the Glenn cases: "And here there was a deed of trust, made by the debtor corporation for the benefit of its creditors; and it has been often ruled in Virginia that the lien of such a deed is not barred by any period short of that sufficient to raise the presumption of payment."[1] In that case the court affirmed a judgment against the stockholders; but the Supreme Court of Alabama, on the second appeal in one of the Glenn cases, expanded the doctrine so as cut the case up by the roots. The corporation, it will be recalled, had been organized in 1865. It had made an assignment of all its assets to trustees for the benefit of its creditors in 1866. These trustees took no steps to execute their trust until 1871, when a general creditors' bill was filed, under which they were ousted and a new trustee (Glenn) was appointed in their stead. The assessment, to enforce which the action was brought, was not ordered by the court superintending the administration until March 26, 1886; and the action at law to enforce the assessment was brought against the stockholder, Semple, on the 19th of November, 1886. More than twenty years having thus elapsed between the date of the execution of the original deed of assignment and the commencement of the action, and there being no evidence of a recognition by the stockholder of his liability during this period, or any other evidence to rebut the presumption of payment springing from the lapse of time, — it was held that the presumption became *conclusive.*[2]

§ 3775. Why a Judicial Call does not Rebut This Presumption of Payment. — Although the stockholders of a corporation who are not made parties to a general creditors' bill to wind up its affairs are bound, on a principle of *representation*,[3] by the decree ordering the assessment, so far as the

[1] Hawkins *v.* Glenn, 131 U. S. 319, 333; citing Smith *v.* Virginia &c. R. Co., 33 Gratt. (Va.) 617; Bowie *v.* Poor School, 75 Va. 300; Hamilton *v.* Glenn, 85 Va. 901.

[2] Semple *v.* Glenn, 91 Ala. 245; *s. c.* 24 Am. St. Rep. 894.

[3] *Ante*, §§ 3049, 3499.

necessity and propriety of the decree are concerned, and possibly for other purposes,— yet it has been held that, for the purpose of charging a particular stockholder with liability, he is not bound by the decree in such a sense as cuts off any defense which he might have interposed against the corporation itself, if the directors had made an assessment and the corporation had brought an action against him to enforce the same. Such a decree does not, it has been held, involve any recognition on his part of his continuing liability as a stockholder, or furnish any other species of evidence, such as will rebut the presumption of payment or settlement springing from the lapse of the period of twenty years. When, therefore, this period had elapsed since the corporation made an assignment to trustees for the benefit of its creditors and became practically dissolved, it was held that, in the absence of any evidence of a recognition of his liability by the stockholder, this presumption constituted a complete defense.[1]

ARTICLE II. WHEN SUCH STATUTES BEGIN TO RUN.

SECTION
3779. Generally from the date of the call under which the action is brought.
3780. Where the statute gives a joint action against the corporation and the stockholders.
3781. From the date of the appointment of a receiver.
3782. In case of a motion for execution under the Missouri statute.

§ 3779. Generally from the Date of the Call under Which the Action is Brought.— We have already had occasion to refer to the general rule that statutes of limitation do not begin to run against actions against stockholders until a *call* has been duly made, either by the directors or by a court of justice administering the assets of the corporation after

[1] Semple *v.* Glenn, 91 Ala. 245, 263; *s. c.* 24 Am. St. Rep. 894. The opinion of the court so holding, delivered by the late Justice Clopton, is valuable as expressing at some length the views of a very competent tribunal as to the extent to which the rights of stockholders are concluded in a general creditors' suit, on the theory of their being *represented in the suit by the corporation*, where they are not actually made parties.

insolvency.[1] Where, as in Virginia, the transferor of shares remains liable for any unpaid balance upon his subscription, although the transferee may become liable also,[2] the rule that a stockholder is not liable to suit for unpaid portions of the capital stock until an authorized call or assessment has been made upon the stock held by him, applies also to a stockholder who has assigned his stock, and the statute of limitations begins to run in his favor, not from the date of the assignment, but from the maturity of the assessment.[3] Where there are *successive assessments*, whether by the directors while the corporation is a going concern, or by order of a court of justice after insolvency, each separate assessment creates a separate right of action, and against that right of action the statute begins to run from the date of that assessment, and not from the date of a previous assessment. It follows that the refusal of the stockholder to pay a prior assessment is not such a denial of his liability for future assessments, as sets in motion the statute of limitations in his favor in respect of the entire unpaid balance due by him on his share subscription.[4]

§ 3780. Where the Statute Gives a Joint Action against the Corporation and the Stockholders.—It may be assumed, on a theory already stated,[5] that where the statute gives a joint action against the corporation and its stockholders, or any of them, the statute of limitations will begin to run in favor of the stockholder at the time when it begins to run in favor of the corporation, and that the same statute will be applicable to both actions.[6] And, generally, it may be concluded that

[1] *Ante*, §§ 2003, 2005. The leading case in support of the doctrine is Scovill *v.* Thayer, 105 U. S. 143. See also Marr *v.* West Tennessee Bank, 4 Lea (Tenn.), 578, 593; Thompson *v.* Reno Savings Bank, 19 Nev. 171; *s. c.* 3 Am. St. Rep. 881; citing Harmon *v.* Page, 62 Cal. 448.

[2] Va. Code, 1873, ch. 57; Hamilton *v.* Glenn, 85 Va. 901; *s. c.* 9 S. E. Rep. 129; McKim *v.* Glenn, 66 Md. 479; *s. c.* 8 Atl. Rep. 130; Hambleton *v.* Glenn, 72 Md. 331; *s. c.* 20 Atl. Rep. 115; Priest *v.* Glenn, 51 Fed. Rep. 400.

[3] Priest *v.* Glenn, 51 Fed. Rep. 400.

[4] Dorsheimer *v.* Glenn, 51 Fed. Rep. 404.

[5] *Ante*, § 2010.

[6] Conklin *v.* Furman, 48 N. Y. 527; affirming *s. c.* 8 Abb. Pr. (N. S.) (N. Y.) 161; 57 Barb. (N. Y.) 484.

where, under the charter of the company, the *liability* of stockholders *is that of partners*, the stockholders occupy, in respect of the statute of limitations, the same relation to the creditors of the corporation which the corporation itself occupies, and that the same statute of limitations is applicable.[1] Accordingly, where the liability of the stockholders of a banking corporation is, under its charter, that of partners, and a depositor brings an action against such a stockholder on a cause of action shown by *credits entered in his bank book*, the cause of action in Illinois is not governed by the statute of five years relating to demands not in writing, but is governed by the statute of *ten years*, relating to *demands in writing*, and the same statute applies which would apply if the action were against the corporation.[2]

§ 3781. From the Date of the Appointment of a Receiver. We have had occasion to note numerous holdings to the effect that, notwithstanding the appointment of a receiver of the assets of the corporation in a creditor's suit, the statute of limitations does not begin to run in favor of the stockholders until *calls* are ordered by the court superintending the administration, and then only from the date of each call, in respect of the right of action to enforce that call.[3] This is not, however, the universal theory. In a case in New York, more than four years after the rendition of a judgment against a corporation sequestrating its property, appointing a permanent receiver of it, and restraining its officers and agents from all interference with it, a creditor of the corporation commenced an action to charge a stockholder with a judgment against it, on the ground that the whole capital stock was not paid in. It was held that the action was barred by the provision of the New York Manufacturing Companies Act that

[1] Shalucky *v.* Field, 124 Ill. 617; *s. c.* 7 Am. St. Rep. 399.

[2] Shalucky *v.* Field, *supra.* "The entries in the bank book were made by the bankers, and they charged themselves with the money deposited. They constitute 'evidence of indebtedness in writing,' within the meaning of the statute." Jassoy *v.* Horn, 64 Ill. 379. See, also, Folz *v.* Nelke, 33 Ill. App. 370.

[3] *Ante*, § 2005.

no suit shall be brought against any stockholder in a company organized under the act, unless the same shall be commenced within *two years* from the time he shall have ceased to be a stockholder;[1] since, upon the appointment of the receiver, the corporation, for all practical purposes, ceased to exist, and the defendant ceased to be a stockholder within the meaning of the statute.[2] The writer respectfully submits that the statute was not intended to mean any thing of the sort, but that it was intended to meet the ordinary case of a person ceasing to be a stockholder by transferring his shares to another. When the receiver takes possession of the assets of a corporation, he does not become the assignee of the shares of its members, and it is a palpable perversion of the meaning of language to say that, from that circumstance, they cease to be stockholders.

§ 3782. In Case of a Motion for Execution under the Missouri Statute. — Where a creditor proceeds by a motion for execution under a Missouri statute already considered,[3] his right to proceed does not accrue until he has recovered a judgment, sued out an execution thereon, and the execution has been returned *nulla bona*.[4] In such cases it must follow that the statute of limitations, for all the purposes of the proceeding, commences to run from the date of the return of *nulla bona*.[5]

[1] Laws N. Y. 1848, ch. 40, § 24.

[2] Hollingshead *v.* Woodward, 107 N. Y. 96; *s. c.* 13 N. E. Rep. 621; 11 N. Y. St. Rep. 325; 2 Rail. & Corp. L. J. 545.

[3] *Ante*, § 3602, *et seq.*

[4] *Ante*, § 3608.

[5] Washington Savings Bank *v.* Butchers' &c. Bank, 107 Mo. 133; *s. c.* 28 Am. St. Rep. 405.

CHAPTER LXX.

SET-OFF.

ART. I. IN GENERAL. §§ 3785–3804.
II. UNDER PARTICULAR STATUTES. §§ 3809–3813.

ARTICLE I. IN GENERAL.

SECTION
3785. Right exists where the corporation is a going concern.
3786. Ceases when the corporation becomes insolvent.
3787. Reasons which deny the right after insolvency.
3788. Right exists where there are no other creditors.
3789. Right exists where the debt of the corporation is a trust fund.
3790. Where the statute gives a direct proceeding at law.
3791. Special contract for a right of set-off.
3792. Distinction between cases where the set-off is executed and where it is unexecuted.
3793. If the shareholder is a bankrupt.
3794. Whether payment of corporate debts pleadable by way of set-off.
3795. Whether stockholder may compound with creditors.
3796. Release by a creditor of a particular shareholder.
3797. Shareholder cannot buy claims at a discount and plead them as offsets.
3798. But may prove as a creditor claims which he has purchased at a discount.
3799. And for stronger reasons a stranger may do so.
3800. Company may set off calls against its own debt.
3801. Setting off unpaid dividends against debts of the corporation.
3802. Where the indebtedness to the stockholder has collateral security.
3803. Shareholder can only assign debt of company subject to right of set-off.
3804. Policy-holders cannot set off loss against liability on premium note.

§ 3785. Right Exists where the Corporation is a Going Concern. — As a corporation is a distinct person in law from each one of its members,[1] and as it may sue one of its members and be sued by him, the same as one natural person may

[1] *Ante*, § 1073, *et seq.*

sue another and be sued by him,—it follows that in any action by a corporation against one of its stockholders, while the corporation is a going concern, the stockholder has the same right to set off any debt, which may be due to him from the corporation, which he would have if sued by a natural person.[1] And the same rules govern, in determining whether the right of set-off exists, which govern in ordinary actions. A leading one of these rules is, that no debts can be set off against each other which are not *mutual*. *Joint* debts cannot be set off against *separate* debts.[2] And, therefore, if a corporation sues a stranger, he cannot set off a debt due to him from a stockholder of the corporation.[3] Upon the same principle, in an action by the assignee of an insolvent corporation to recover a debt, the defendant is not entitled to set off a claim due from the corporation to a *firm* of which he is a member.[4] Nor can a stockholder, by paying a debt due by the corporation to a *firm* of which the stockholder is a member, extinguish his liability to other creditors of the corporation.[5]

§ 3786. Ceases when the Corporation Becomes Insolvent. But the right of set-off resembles, in one respect, the right of *rescission for fraud;*[6] it ceases as soon as the corporation becomes *insolvent,*[7] or where it is in *bank-*

[1] Garnet &c. Mining Co. *v.* Sutton, 3 Best & S. 321.

[2] Lind. Part., 5th ed., 290, *et seq.;* Scammon *v.* Kimball, 92 U. S. 362, 367; Balch *v.* Wilson, 25 Minn. 299; *s. c.* 33 Am. Rep. 467.

[3] Lind. Comp., 5th ed., 273.

[4] Howe *v.* Snow, 3 Allen (Mass.), 111. It has been held that in a suit by a corporation against a stockholder, defendant may set off any sum fraudulently obtained from him as subscription, unless there are debts of the corporation incurred since his subscription, equal to said sum or greater. Hamilton *v.* Grangers' Life &c. Ins. Co., 67 Ga. 145.

[5] Buchanan *v.* Meisser, 105 Ill. 638.

[6] *Ante,* § 1448, *et seq.*

[7] Sawyer *v.* Hoag, 17 Wall. (U. S.) 610; McAvity *v.* Lincoln Pulp &c. Co., 82 Me. 504; *s. c.* 20 Atl. Rep. 82; Shickle *v.* Watts, 94 Mo. 410; Tama-Water Power Co. *v.* Hopkins, 79 Iowa, 653; *s. c.* 44 N. W. Rep. 797; Boulton Carbon Co. *v.* Mills, 78 Iowa, 460; *s. c.* 5 L. R. A. 649; 43 N. W. Rep. 290; Scovill *v.* Thayer, 105 U. S. 143; Scammon *v.* Kimball, 92 U. S. 362; Handley *v.* Stutz, 139 U. S. 417; Maritime Bank Liquidators *v.* Troop, 16 Sup. Ct. Can. 456; *s. c.* 31 Am. & Eng. Corp. Cas. 410. Such is the rule under the *English* Companies Act, 1862,

ruptcy,[1] with certain exceptions hereafter noted. The stockholder cannot, in a proceeding against him by or on behalf of a creditor or creditors, set off a debt due to him by the corporation.[2] Where there is a *general winding-up proceeding*, either by means of a receiver in a court of equity,[3] or by means of a receiver or liquidator appointed under a statute, such as the

in respect of limited companies: Grissell's case, L. R. 1 Ch. 528; Black & Co.'s case, L. R. 8 Ch. 254; Calisher's case, L. R. 5 Eq. 214; Barnett's case, L. R. 19 Eq. 449. *Contra*, in case of a voluntary winding up: Brighton Arcade Co. *v.* Dowling, L. R. 3 C. P. 175. This, as explained by Sir N. Lindley, differs from the rule which prevailed under the Acts of 1856–1858. See 21 & 22 Vict., ch. 60, § 17, and Garnet &c. Min. Co. *v.* Sutton, 3 Best & S. 321; Barrett's case, 4 De Gex, J. & S. 416 and 756. The present law of England, and the distinction in respect of this right, depend on the interpretation of statutes, and are explained by the same author in Lind. Comp. Law, 5th ed., 557. See Gill's case, 12 Ch. Div. 755; Re Whitehouse, 9 Ch. Div. 595; Garnet &c. Mining Co. *v.* Sutton, 3 Best & S. 321; Ex parte Brown, 12 Ch. Div. 823; Ex parte Mackenzie, L. R. 7 Eq. 240; Ex parte Cannon, 30 Ch. Div. 629; Re Addlestone Linoleum Co., 37 Ch. Div. 191; Calisher's case, L. R. 5 Eq. 214. The *leading case* seems to be Grissell's case, L. R. 1 Ch. 528. Compare the seemingly overruled case of Brighton Arcade Co. *v.* Dowling, L. R. 3 C. P. 175; and see Thomp. Stockh., § 383. A set-off was disallowed in the following cases: Re Masons' Hall Tavern Co., L. R. 5 Eq. 286; Sankey Brook Coal Co. *v.* Marsh, L. R. 6 Exch. 185. It was *allowed* under the facts of the following cases: Re London & Colonial Co., L. R. 7 Eq. 550; Re City Terminus Hotel Co., L. R. 14 Eq. 10. A number of *contrary and confusing decisions* on this subject were noted by the author in his work on stockholders (Thomp. Stockh., § 381), and their reasoning explained. These, together with some others, will now be cited merely: Briggs *v.* Penniman, 8 Cow. (N. Y.) 387, 390; *s. c.* 18 Am. Dec. 454; Tallmadge *v.* Fishkill Iron Co., 4 Barb. (N. Y.) 382, 391 (quoted with approval in Robinson *v.* Bank of Darien, 18 Ga. 65, 109); Boyd *v.* Hall, 56 Ga. 563; Belcher *v.* Willcox, 40 Ga. 391; Haynes *v.* Kent, 8 La. Ann. 132 (making the stockholder a *preferred creditor* merely because he is a stockholder); Remington *v.* King, 11 Abb. Pr. (N. Y.) 278; Richards *v.* Crocker, 19 Abb. N. Cas. (N. Y.) 73; Christensen *v.* Colby, 43 Hun (N. Y), 362; Marr *v.* West Tennessee Bank, 4 Lea (Tenn.), 578.

[1] Sawyer *v.* Hoag, 17 Wall. (U. S.) 610, 622; followed in Scammon *v.* Kimball, 92 U. S. 362.

[2] Matter of Empire City Bank, 18 N. Y. 199, 227; Lawrence *v.* Nelson, 21 N. Y. 158; Hillier *v.* Allegheny County Ins. Co., 3 Pa. St. 470; *s. c.* 45 Am. Dec. 656; Matthews *v.* Albert, 24 Md. 527; Grose *v.* Hilt, 36 Me. 22; Thompson *v.* Reno Savings Bank, 19 Nev. 103; *s. c.* 3 Am. St. Rep. 797.

[3] Scammon *v.* Kimball, 92 U. S. 362, 367; Shickle *v.* Watts, 94 Mo. 410, 418.

English Companies Act,[1] or a similar statute in Canada,[2] or the United States National Banking Act,[3] or the late Federal Bankruptcy Act,[4] or a State insolvency law,[5]—no right of set-off exists in favor of the shareholder; since to allow such a right would be to allow a preference to the shareholders over other creditors. On the contrary, they must pay up what they owe like other debtors, and then get their dividends like other creditors.

§ 3787. Reasons Which Deny the Right after Insolvency. 1. The first reason generally given for the rule denying the right of set-off after a corporation has become insolvent, is the theoretical reason which often operates to deny the right of set-off in courts of law, which is, that there can be no set-off unless the *debts* are *mutual* and *in the same right.*[6] Briefly explained, the meaning is, that when the assets have been impressed with the quality of a *trust fund* for the equal benefit of all the creditors, their custodian, whether the corporation, its directors, a receiver, assignee, or other liquidator, holds them, not in right of the corporation, against which the set-off is claimed, but in right of the creditors. This reason is even more applicable to cases where a creditor or his representative proceeds to enforce a *statutory individual liability;* since such a liability is not a debt due by him to the company; it is not an asset of the company, and cannot, without the aid of a statute so authorizing, be sued for by a

[1] *Post,* § 3791; Re Stranton Iron &c. Co., L. R. 19 Eq. 449; Re Breech-Loading Armoury Co., L. R. 5 Eq. 214; Re Whitehouse, 9 Ch. Div. 595; 47 L. J. Ch. 801; 39 L. T. (N. S.) 415; 27 Week. Rep. 181; Gill's case, 12 Ch. Div. 755.

[2] Maritime Bank Liquidators *v.* Troop, 16 Sup. Ct. Can. 456; *s. c.* 31 Am. & Eng. Corp. Cas. 410.

[3] Sowles *v.* Witters, 39 Fed. Rep. 403; Stephens *v.* Schuchmann, 32 Mo. App. 333.

[4] Sawyer *v.* Hoag, 17 Wall. (U. S.) 610, 622; Scammon *v.* Kimball, 92 U. S. 362.

[5] McAvity *v.* Lincoln Pulp &c. Co., 82 Me. 504; *s. c.* 20 Atl. Rep. 82.

[6] Sawyer *v.* Hoag, 17 Wall. (U. S.) 610, 622; Scammon *v.* Kimball, 92 U. S. 362, 366, where the reasons are stated by Mr. Justice Clifford. To the general doctrine, see United States *v.* Eckford, 6 Wall. (U. S.) 484, 488.

receiver of the company.[1] On the contrary, it is a liability, in the nature of a guaranty or a superadded security, flowing directly from the stockholder to the creditors. Hence, there is no mutuality between such a liability and a debt due by the corporation to the stockholder. The same is true when the liability is for moneys due on account of stock held by him which has not been fully paid.[2] Such a debt, as we have seen,[3] is deemed in equity a part of the capital stock of the company, and is a trust fund to be devoted to the payment of *all* its creditors; and hence, whilst the company, as long as it continues a going concern, may call it in, and the stockholder, without doubt, set off against it any demand he may have against the company, yet when the company becomes insolvent, and there is not enough to satisfy all its creditors, this trust fund manifestly cannot be appropriated by a creditor who is a stockholder, to the exclusive payment of his own claim.[4] Substantially the same reasons are held in the English courts of equity. The winding-up acts of that country are framed on the idea of doing justice to creditors by allowing them to share *pari passu*. By allowing the right of set-off to a shareholder who is a creditor, he thereby obtains

[1] *Ante*, § 3560.

[2] Black & Co.'s case, L. R. 8 Ch. 261. "What," said Lord Chelmsford, in this case, "is the ordinary law of set-off? It is what, in the civil law, was called *compensation*, and simply means this: that when you have got two cross-demands, of a nature substantially the same, and due to and from A. and B. in the same right, — that is to say, when the one is a creditor in his own right, and debtor also in his own right, to the other, — the one debt may be set off against the other, at the option of the party from whom payment is demanded. But it is essential, in such cases, that the rights should be substantially the same. If they were apparently the same at law, but different in equity, set-off would not be allowed here; nor do I suppose that, in the present state of the law, it would be allowed at common law either. But here the rights are substantially different. The moment that the winding-up takes place, the whole administration is carried on with a view to the payment of the debts of the creditors, and in the first instance to payment *pari passu*."

[3] *Ante*, § 2952. See, also, *post*, § 3789.

[4] Hillier *v.* Allegheny County Mutual Ins. Co., 3 Pa. St. 470; *s. c.* 45 Am. Dec. 656; Lawrence *v.* Nelson, 21 N. Y. 158; Sawyer *v.* Hoag, 17 Wall. (U. S.) 622.

a preference over other creditors.[1] 2. It is but another way of stating this principle to say that a creditor who is himself a stockholder has not a claim against one or more, or all, of his co-stockholders for the full amount of his debt, but has only a claim against them for *contribution;* and hence, as already seen, he cannot, in general, sue one or more of them at law, but must go into equity;[2] or, if proceeded against in equity, he is entitled to an equitable allowance on account of payments made for, or advances made to, the company, on the principle of contribution.[3] 3. The disallowance of the right of set-off does the shareholder no injustice, because, if the company is insolvent, he will share *pari passu* with other creditors; whereas, if there is enough to pay all the debts in full, of course his debt will be paid among the rest, and the right of set-off will not be wanted to do justice between him and the other shareholders.[4]

§ 3788. Right Exists where there are No Other Creditors. Where the object of the proceeding is to sequester what remains unpaid by the stockholder to the corporation upon his share subscription, and there are no other creditors, then no reason exists why he should not be exonerated to the extent of his demand against the corporation.[5]

§ 3789. Right Exists where the Debt of the Corporation is a Trust Fund. — Where the obligation of the corporation to the stockholder is not an ordinary debt, but consists of a *fund held by the corporation upon a trust,* so that the corporation would be bound to restore the whole of it without regard to the rights of other creditors, then, obviously, a right of set-off exists in favor of the stockholder to the extent of such a

[1] Grissell's case, L. R. 1 Ch. 528; Black & Co.'s case, L. R. 8 Ch. 254.

[2] *Post,* §§ 3816, 3829; Thayer *v.* Union Tool Co., 4 Gray (Mass.), 75; Woodruff & Beach Iron Works *v.* Chittenden, 4 Bosw. (N. Y.) 406; Beers *v.* Waterbury, 8 Bosw. (N. Y.) 396.

[3] Briggs *v.* Penniman, 8 Cow. (N. Y.) 387, 397; *s. c.* 18 Am. Dec. 454 (decree); Slee *v.* Bloom, 19 Johns. (N. Y.) 456, 485; *s. c.* 10 Am. Dec. 273 (decree).

[4] Black & Co.'s case, L. R. 8 Ch. 254, 261.

[5] McAvity *v.* Lincoln Pulp &c. Co., 82 Me. 504; *s. c.* 20 Atl. Rep. 82.

fund. This may be illustrated by a case where the receiver of an insolvent national bank brought an action at law against a stockholder to recover an assessment on his shares. The stockholder set up, by way of *counterclaim*, that, before the bank failed, the Comptroller of the Currency had ordered the restoration by the bank, of the value of certain securities which had been reported worthless by the bank examiner, and that defendant and other stockholders had raised a fund to be applied, from time to time, toward the retirement of such securities; but that the receiver, though knowing this, claimed the balance of the fund which was in the bank when it failed, as part of the ordinary assets of the bank. It was held that the part of this balance belonging to the stockholder might be set off against his assessment.[1] But this doctrine has been held to have no application to a case where a stockholder *lends securities to the corporation* to help it over a crisis. Accordingly, where an executor during a financial crisis of a bank, of which a residuary legatee was a stockholder, delivered shares standing in the latter's name to aid the bank in the emergency, and, upon such transfer coming to the knowledge of a residuary legatee, he was assured that if the bank was saved the stocks would be returned, but if it failed the avails would be applied on his assessment, and he thereupon assented to the retention of the stock,—it was held that he stood on the same footing as other creditors, and was not entitled to set off against his assessment the value of the shares.[2]

§ 3790. Where the Statute Gives a Direct Proceeding at Law.—Where either the governing statute, or the rule of decision in the particular forum, gives to a single creditor a direct proceeding at law against any stockholder,—this action, from its very nature, proceeds in disregard of the rights of other creditors.[3] The plaintiff will have a right of recovery

[1] Welles *v.* Stout, 38 Fed. Rep. 807; *s. c.* 1 Bank. L. J. 303.

[2] Sowles *v.* Witters, 39 Fed. Rep. 403.

[3] Some of the "contrary and confusing" decisions previously noted (*ante*, § 3786, note) may possibly be *reconciled* on the grounds here stated.

against the defendant for enough of so much as may be due from him to the corporation upon his share subscription, or for enough of the amount which he stands liable to pay towards liquidating its debts in addition thereto, as an individual liability under the governing statute, to satisfy the demand of the plaintiff and also the costs of his action. In such a case the principal reason on which courts of equity proceed in denying the right of set-off,—that a creditor stockholder must pay up his contribution in full and then take his dividend on an equal footing with the other creditors,—does not exist; though the more technical reason of a want of mutuality between the debts of the plaintiff creditor and the defendant stockholder still exists. This last reason may or may not operate to deny the right of set-off according to the theories which exist in the particular forum. Where the proceeding is by *garnishment*, logically the right of set-off exists.[1] And, no doubt, the right exists where the proceeding is by motion for an execution under a statute, and in other cases where the proceeding is an *action at law*, or a proceeding of that nature.[2]

§ **3791. Special Contract for a Right of Set-off.** — It was at one time doubted by Lord Romilly, M. R., whether a special agreement between a shareholder and the company, to the effect that he might set off money due him from the company against calls made on his shares, would be valid after an order to wind up, although the calls were made before that time.[3] But it was subsequently held by the Court of Appeal in Chancery, by Lord Chancellor Selborne and the Lords Justices James and Mellish, that such an agreement would not be valid. The case was, that a contractor had agreed with a

[1] *Ante*, § 3576, *et seq.*

[2] When, therefore, the liability is an individual liability, not to the corporation, but directly to its creditors, if a stockholder, so individually liable, recovers a judgment against the corporation, and agrees with the corporation to satisfy the judgment in consideration of a release of his individual liability, a court will, in a proper proceeding, *vacate* the *satisfaction of the judgment:* Gentry *v.* Alexander, 16 Ind. 471.

[3] Calisher's case, L. R. 5 Eq. 214.

company to supply them, for ten years, with all the locomotive engines which the company should require. During each of the first five years the company were to accept at least four of such engines, and during each of the next two years two of such engines. The first order was to be for two engines. All the engines were to be paid for when the delivery notes of the same were presented at the offices of the company, and instead of paying cash, the company was to be allowed to give acceptances. The contractor agreed to subscribe for a certain number of shares in the company and to pay a specified sum for each share, such sum being the amount of calls then made. It was also agreed that no further payment of calls should be enforced in respect of such shares until at least two engines should have been paid for, and that the contractor might set off against the calls upon all or any of the said shares the amount which was due him, or for which he held the company's acceptances. It is perceived that this contract was, in substance, to take shares and pay for them in specific property. The contractor took the shares, accordingly, and made two engines, which were never taken or paid for by the company, but it was ordered to be wound up, and a call was made on the shares by the liquidator. It was held that the contractor could not set off the amount due him under the contract, as damages or otherwise, against the call.[1] But where, by an agreement between a shareholder in a company and the company, a present liability of the company to pay cash to him was set off against future calls on his shares, it was held that this was payment of the shares in cash, within the meaning of the English Companies Act, 1867, and he was not liable as a contributory in respect of such shares in the winding up of the company.[2] Where a subscription to the stock of a corporation is paid by the note of the subscriber, money subsequently paid by the stockholder to the corporation for the purpose of repairing its capital stock, under an agreement

[1] Black & Co.'s case, L. R. 8 Ch. 254; Re Paraguassu Steam Tramroad Co., L. R. 8 Ch. 254; disapproving Brighton Arcade Co. *v.* Dowling, L. R. 3 C. P. 175.

[2] Re Jones, 41 Ch. Div. 159.

that, as between the corporation and its creditors, the payment is a *donation*, but as between the stockholders, a *debt*, and upon the further agreement that such payment is to be regarded as a satisfaction *pro tanto* of the individual liability of the stockholder to creditors, — cannot, after the corporation has become insolvent, be set off against the stock note.[1]

§ 3792. Distinction between Cases where the Set-off is Executed and where It is Unexecuted. — Remembering that a set-off is available against the corporation so long as it continues a going concern,[2] it must follow that where a corporation and its creditor have agreed to set off mutual debts against each other, this agreement will stand, in the absence of fraud, after the corporation becomes insolvent, on the ground of being an *executed contract.* Several cases in England have been decided with reference to this principle; but it will appear, from the expressions of the English judges and from a little reflection, that the question relates to the law of *payment* rather than to the law of set-off. Dealing with this phase of the question, it was said by James, L. J.: "If it came to this, that there was a debt in money payable immediately by the company to the shareholders, and an equal debt payable immediately by the shareholders to the company, and that each was accepted in full payment of the other, the company could have pleaded payment in an action brought against them, and the shareholder could have pleaded payment in cash in a corresponding action brought by the company against him for calls. Supposing the transaction to be an honest transaction, it would, in a court of law, be sufficient evidence in support of a plea of payment in cash, and it appears to me that it is sufficient for this court sitting in a winding-up matter."[3] In the same case, Mellish, L. J., added: "Nothing is clearer than that if parties account with each other, and sums are stated to be due on one side, and sums to an equal amount due on the other side on that account, and those accounts are settled by

[1] Union Central Life Ins. Co. *v.* Jones, 35 Ohio St. 351.

[2] *Ante*, § 3786.

[3] Spargo's case, L. R. 8 Ch. 412.

both parties, it is exactly the same thing as if the sums due on both sides had been paid. Indeed, it is a general rule of law that in every case where a transaction resolves itself into paying money by A. to B., and then handing it back again by B. to A., if the parties meet together and agree to set one demand against the other, they need not go through the form and ceremony of handing the money backwards and forwards."[1] And this is in conformity with what has been said in another case: "That was merely allowing substance to prevail over form, — that is to say, that it should not be necessary in such a case for the company to pay their debt to the shareholder, and for the shareholder to pay his debt to the company, either by giving money one to the other, or by the company handing over a cheque to the shareholder and his handing it back again."[2] The meaning is, that where, as between the corporation and its creditor, there is a cross-indebtedness, and both debts are presently payable, and the parties meet and settle and agree to set the one debt off against the other, that agreement pays both debts, and it is neither necessary that money should be passed back and forth over the counter, nor that there should be an exchange of cheques on the banker.[3] But this principle has no application where the debts are not presently payable, and where there is no present agreement for a set-off under circumstances which execute the mutual contracts of the parties, and create in law a payment of both debts; nor has it any just application to agreements made in contemplation of insolvency (except possibly in those American jurisdictions where the wretched doctrine prevails that a corporation may prefer its creditors); because to allow the parties to effect a set-off under such circumstances would be to allow the corporation to defeat the policy of the law, which is that its assets, being a trust fund for all its creditors, shall be ratably distributed among them, and that it shall not prefer one over another by doing that which amounts to a payment of his debt in full. This is well

[1] Spargo's case, L. R. 8 Ch. 414.

[2] White's case, 12 Ch. Div. 511.

[3] See Kent's case, 39 Ch. Div. 259.

illustrated by an English case where, by the articles of association, the directors were empowered to receive from any member willing to advance the same, all or any part of the money due upon his shares beyond the sums actually called for. Kent, a shareholder in the company and formerly the managing director of it, took an assignment from one of its creditors of a debt due by it, which was payable in installments, but none of which installments were due, and requested the directors to apply a sufficient part of the debt in paying in full the shares standing alone in his name, on which shares no call was at that time payable. The directors passed a resolution to that effect. In the mean time a petition to wind up the company had been filed; but before any thing further was done to carry the transaction into effect, or before any entry of it had been made on the books of the company other than the minute of the resolution, an order to wind up the company was made. It was held that this set-off could not be allowed. The lords justices took the view that what had been done was not a payment *in præsenti*, but merely an agreement for a payment *in futuro*, and that what had been done could not have been successfully pleaded as a payment in a court of law.[1] This case, while rightly decided, seems to have been decided on an untenable ground. It should really seem that an agreement for a set-off, made between the creditor and the directors, and expressed in the resolution exhibited by the minutes of their proceedings, effected an executed contract of payment. The true ground of the decision was, it should seem, that what was done was done on the eve of the suspension and in contemplation of winding-up proceedings, and to defeat the policy of the law by preferring a favored shareholder who had been a director and manager of the company, to the extent of allowing him to pay his debt to the company in full by buying up one of its outstanding obligations and procuring a set-off. This, as hereafter seen, even the American courts do not permit.[2] In a later case in the English Chancery Division, decided by a single judge, the case last cited is distinguished,

[1] Kent's case, 39 Ch. Div. 259.

[2] *Post*, § 3797.

Mr. Justice North holding that where a company owes to one of its shareholders a debt which is presently due and payable, and the shareholder is contingently liable to the company in respect of an unpaid balance on his shares, which balance has not been called for by the directors, an agreement to set off this debt of the company against the shareholder's liability for his unpaid balance is an executed agreement of set-off, within the principle above stated, such as will hold good after the company passes into the hands of an official liquidator, in a proceeding to wind it up under section 25 of the Companies Act, 1867.[1]

§ **3793. If the Shareholder is a Bankrupt.** — The principle of allowing mutual debts to be set off against each other has always obtained in the statutes of bankruptcy which have existed in England[2] and in this country.[3] This principle appears to antedate the provisions of the English statutes of bankruptcy on the subject, and to have existed long before the English statute of set-off.[4] Now, the principle being established, in winding up a corporation, that a shareholder cannot set off, against his liability as a contributory, a debt due him from the company, and it being equally well settled that, in collecting the estate of a bankrupt, his debtors may claim such right as against his assignee, — suppose that a corporation is being wound up, and is indebted to one of its shareholders, who is in bankruptcy, and such bankrupt shareholder is assessed as a contributory, will his assignee or trustees be entitled to claim a set-off as against the receiver or liquidator of the company? It has been held by the English Court of Appeal in Chancery, while conceding the correctness of the rule in Grissell's case,[5] that a right of set-off in such a case

[1] Re Jones, Lloyd & Co., 41 Ch. Div. 159.

[2] Stat. 12 & 13 Vict., ch. 106, § 117; 32 & 33 Vict., ch. 71, § 39.

[3] Acts March 2, 1867, ch. 176, § 20 (14 Stat. U. S. 526; Rev. Stat. U. S. 5073); April 4, 1800, ch. 19, § 42 (2 Stat. U. S. 33); August 19, 1841, ch. 9, § 5 (5 Stat. U. S. 444).

[4] 2 Geo. II., ch. 22; Garnet &c. Mining Co. *v.* Sutton, 3 Best & S. 321, 324, *per* Blackburn, J.; Christian's Bankrupt Law, 2d ed., 499, and cases cited.

[5] L. R. 1 Ch. 528.

might be claimed by the trustees of the bankrupt shareholder. The case proceeded upon a comparison of the respective provisions of the two statutes applicable to the subject, — the Companies Act, 1862, § 95, and the Bankruptcy Act of 1849, § 171; and the meaning of the statutes was held to be that the liquidator of the company was to go into the court of bankruptcy and prove against the estate of the shareholder for the amount for which the latter was liable as a contributory, allowing the set-off provided for in the Bankruptcy Act; in other words, that the rule of the Bankruptcy Act, and not that of the Companies Act, must prevail.[1] The English rule is, that whether the liquidator of the company proves against the estate of the bankrupt,[2] or whether the trustee in bankruptcy proves against the company,[3] the balance due from one estate to the other, after setting off all mutual debts and credits, is all that can be proved.[4]

§ **3794. Whether Payment of Corporate Debts Pleadable by Way of Set-off.**— This question involves at the outset the inquiry whether the payment attempted to be pleaded as a set-off was *voluntary* or *involuntary*. The well-known rule is, that where one man voluntarily or officiously pays the debt of another, he does not thereby make that other his own debtor to the extent of such payment, in the absence of a subsequent ratification.[5] On this principle, where a stockholder, voluntarily and without legal compulsion, pays the debt of the corporation, he does not thereby acquire a right of reimbursement against the corporation which he can use as a set-off in a proceeding to charge him as a stockholder, or on which he can found an action against other stockholders for a contribution.[6]

[1] Re Duckworth, L. R. 2 Ch. 577; Carralli's Claim, L. R. 4 Ch. 174; Ex parte Strang, L. R. 5 Ch. 492.

[2] Re Duckworth, L. R. 2 Ch. 578; Ex parte Strang, L. R. 5 Ch. 492.

[3] Carralli's Claim, L. R. 4 Ch. 174.

[4] Lind. Comp., 5th ed., 743. See *Id.*, 577, for a further exposition of the subject.

[5] Winsor *v.* Savage, 9 Met. (Mass.) 346.

[6] Eastman *v.* Crosby, 8 Allen (Mass.), 206; Andrews *v.* Callender, 13 Pick. (Mass.) 484; Grose *v.* Hilt, 36 Me. 22.

The same principle has been applied in the case of advances made by a member of an *association* which was governed by the principles applicable to *partnerships*. The association had been organized for the purpose of carrying on a manufacture, but had failed while its buildings were in progress. One of the partners, after all the others had abandoned the enterprise and determined to make no further advances to it, made advances without their consent or authority, for the purpose of preserving the buildings. The buildings were afterward sold for the common benefit. It was held that, in taking an account of the concern, he was not entitled to credit for these advances.[1] The foregoing decisions certainly do not rest upon a very high plane of equity. The debts of a corporation are debts incurred in the prosecution of enterprises undertaken, in a sense, by their stockholders, and for their benefit. They are, therefore, morally, although not in a legal sense, the debts of the stockholders themselves; and they stand under a moral obligation to pay them. When a stockholder comes forward and pays the debts of the corporation, his position ought not, therefore, to be regarded, at least in a court of equity, as the position of an officious intermeddler who undertakes to make a stranger his debtor by paying a debt due from that stranger to another.[2] It is held in a recent case in Vir-

[1] Skinner *v.* White, 1 Hopk. Ch. (N. Y.) 107.

[2] A later case in Massachusetts, distinguishing two of the earlier holdings of the same court above cited, exhibits a better sense of equity. Certain parties had subscribed to an agreement to purchase and run a ferry-boat, to be owned by them in proportion to the amount set against their names, the toll to be applied to pay expenses, and any balance to be divided among them *pro rata*, each subscriber to have the right to sell his stock, the purchaser to have all the rights of an original subscriber, and the association to continue as long as the majority of the subscribers should determine. The court held such subscribers to be partners, and that one of them might maintain a bill in equity against the others, within the jurisdiction of the court, to compel them to contribute to sums paid by him, although not at their request, for the use of the association, and that the amount of the liability of the defendants should be determined by an apportionment among them of the amount paid, without regard to subscribers out of the jurisdiction. Whitman *v.* Porter, 107 Mass. 522.

ginia, under a statute making each stockholder, to the extent of his holding, individually liable for the debts of the corporation, — that, where a stockholder *pays* the debt of the corporation, and takes an assignment of it to himself, he cannot *revive* it by assigning it to a third party; and that where real estate, on which there is a *vendor's lien*, is conveyed to a corporation, and one of its stockholders pays off the lien, and takes an assignment of it to himself, the lien is extinguished as against the other creditors of the corporation, and the stockholder so acting cannot *revive* it by assigning it to a third party.[1] It has been held in Massachusetts that where an action is brought by an assignee of a corporation against one who is a stockholder therein, not to enforce any liability as a stockholder, but to recover an ordinary debt due from him to the corporation, — he cannot avail himself, by way of set-off, of an amount which he has been compelled to pay, subsequently to the commencement of proceedings in insolvency, toward liquidating the debts of the company.[2] The reason is that, to allow such an offset, would be, in effect, exactly the same as allowing it in the case in which the stockholder had been compelled to make advances toward liquidating the debts of the company. It would, under the rule of equity already cited,[3] give him an advantage over other creditors in the distribution, because it would give him payment of his debt in full; whereas, as we have seen, he is bound to pay only what he owes the corporation, and then take his distributive share of any dividend which may be declared, *pari passu* with the other creditors.

§ 3795. Whether Stockholder may Compound with Creditors. — The law does not favor litigation, but encourages compromises and voluntary settlements of controversies, when fairly made. When, by the insolvency of a corporation, the liability of a shareholder therein to pay a given amount to its

[1] Hardy *v.* Norfolk Man. Co., 80 Va. 404.

[2] Howe *v.* Snow, 3 Allen (Mass.), 111.

[3] *Ante*, § 3787.

creditors becomes fixed, creditors may stand greatly in need of payment; their respective debts, as in the case of savings bank deposits or laborers' wages, may be so small as not to justify the expense and trouble of litigation. Under such circumstances, there seems to be neither justice nor sense in requiring a shareholder, in order to discharge himself safely of his liability, to defer payment until creditors have actually proceeded against him. In those States where the rights of all creditors and all shareholders are required to be adjusted in a single suit in equity, it is supposed that a payment made by a shareholder to a particular creditor would, like an unlawful preference in bankruptcy, be treated as a payment in his own wrong. But where a single creditor is at liberty to proceed against a single shareholder, acquiring a preference over other creditors as the reward of his diligence, no reason is perceived for prohibiting the creditor from settling with him until he has commenced suit. The Supreme Court of Georgia has so held, and has carried the rule very far. In the view of that court, a stockholder in a savings bank, individually liable to a limited extent to depositors, might, when proceeded against by a depositor, not only defend by showing that he had discharged himself from the liability cast upon him, but it was deemed wholly immaterial to the plaintiff how that liability was discharged.[1] But, for reasons elsewhere stated, after suit brought by one creditor, he cannot discharge himself by making payment to another.[2]

§ **3796. Release by a Creditor of a Particular Shareholder.** It is familiar law that a release under seal by a creditor or obligee of one joint, or joint and several debtor or obligor, will discharge the whole.[3] A release extinguishes the obligation.[4]

[1] Jones *v.* Wiltberger, 42 Ga. 575, 578.

[2] *Post,* §§ 3835, 3838.

[3] Cheetham *v.* Ward, 1 Bos. & Pul. 630, 633; Rowley *v.* Stoddard, 7 Johns. (N. Y.) 210; American Bank *v.* Doolittle, 14 Pick. (Mass.) 123, 126; Tuckerman *v.* Newhall, 17 Mass. 581, 583; Armstrong *v.* Hayward, 6 Cal. 183; Prince *v.* Lynch, 38 Cal. 528; *s. c.* 99 Am. Dec. 427.

[4] McCrea *v.* Purmort, 16 Wend. (N. Y.) 460; *s. c.* 30 Am. Dec. 103.

This rule, however, has no application to a release, by a creditor, of guarantors or sureties. A release of them does not discharge the principal; but, on the other hand, a release of the principal debtor, of course, releases a surety or guarantor.[1] What application has this doctrine to the case of a creditor of a corporation releasing the company, or one of its members? Under any view of the relation of stockholders to the creditors of the corporation, it is obvious that a release of the company would extinguish the debt and release all its members.[2] But it has also been held that a release of a particular stockholder of a corporation, under a statute making each stockholder jointly and severally liable with the others for *his proportion* of the corporate debts,[3] operates as a release of this indebtedness as to all.[4] If, after the retiring of a stockholder from the corporation by the sale of his stock, and due public notice thereof as required by the charter, the creditor gives up old notes, upon which the stockholder was liable, and takes new ones, especially if done for the purpose of absolving *him* from liability, and imposing it upon his successor in the stock, this operates as a complete release to him of the debt, both at law and in equity.[5]

§ 3797. Shareholder cannot Buy Claims at a Discount and Plead Them as Offsets. — A stockholder — especially if he is an *officer* of the corporation — will not be permitted to buy up judgments or other claims of an insolvent corporation, and, when proceeded against as a stockholder by a creditor, to plead them as offsets against his liability as such. This is especially true where there is a personal liability on the part of the stockholder under the charter.[6] But where, under the theory

[1] Crockett, J., in Prince *v.* Lynch, 38 Cal. 528, 537; *s. c.* 99 Am. Dec. 427; Trotter *v.* Strong, 63 Ill. 272; Brown *v.* Ayer, 24 Ga. 288; Lewis *v.* Jones, 4 Barn. & Cress. 506.

[2] Crockett, J., in Prince *v.* Lynch, 38 Cal. 528; *s. c.* 99 Am. Dec. 427.

[3] Larrabee *v.* Baldwin, 35 Cal. 155.

[4] Prince *v.* Lynch, 38 Cal. 528, 538; *s. c.* 99 Am. Dec. 427, Crockett, J., dissenting.

[5] New England Commercial Bank *v.* Stockholders, 6 R. I. 154; *s. c.* 75 Am. Dec. 688.

[6] Thompson *v.* Meisser, 108 Ill. 359; Bulkley *v.* Whitcomb, 49 Hun

of the law which prevails in the particular forum, a general right of set-off is conceded to the stockholder, he will be allowed, as against creditors of the corporation, what he actually expended in the purchase of such claims.[1] While a stockholder, who is proceeded against in respect of his *individual statutory liability*, can plead, by way of defense, a *bona fide* payment made by him of a debt of the corporation to another of its creditors,[2] yet he cannot, where he has purchased judgments or other evidences of debt against it, set them up as payments under this rule, at their face value, though it is conceded that he can set them up to the extent of what he has actually paid for them.[3]

§ 3798. But may Prove as a Creditor Claims Which He has Purchased at a Discount. — But whilst a shareholder cannot, after the insolvency of the corporation, buy up claims against it and set them off against his liability for unpaid stock,[4] there seems no very clear reason, unless he is a director, or otherwise in a fiduciary relation with the company, for prohibiting him from buying up claims against the company at a discount, and proving them up, as a creditor, at their par value. This question was distinctly put to that eminent equity judge, the late Lord Romilly, M. R., and he decided,

(N. Y.), 290; *s. c.* 17 N. Y. St. Rep. 652; 1 N. Y. Supp. 748; Abbey *v.* Long, 44 Kan. 688; *s. c.* 24 Pac. Rep. 1111; Gauch *v.* Harrison, 12 Ill. App. 459; Diven *v.* Phelps, 34 Barb. (N. Y.) 224; Smith *v.* Mosby, 9 Heisk. (Tenn.) 501. That such is the rule in *bankruptcy* in England, where the right of set-off depends on the state of things existing at the date of the bankruptcy, see Re Gillespie, 14 Q. B. Div. 963; Dickson *v.* Evans, 6 T. R. 57. See, also, Ex parte Theys, 25 Ch. Div. 587. Sir N. Lindley says that the practice in this particular is not yet settled under the English Companies Act: Lind. Comp. Law, 5th ed., 739. It was also the rule under the late Federal Bankruptcy Act: Sawyer *v.* Hoag, 17 Wall. (U. S.) 610, 623, where the reasons are given by Mr. Justice Miller. See, also, Lawrence *v.* Nelson, 21 N. Y. 158.

[1] Lingle *v.* National Ins. Co., 45 Mo. 109; Gauch *v.* Harrison, 12 Ill. App. 457.

[2] *Ante*, § 3795.

[3] Thompson *v.* Meisser, *supra;* Abbey *v.* Long, *supra.* There is a holding that if a subscriber has paid in depreciated bills of the bank, he is entitled to be credited with their value at the time of payment. Marr *v.* West Tennessee Bank, 4 Lea (Tenn.), 578.

[4] *Ante*, § 3797; *post*, § 4040.

without the expression of any doubt, that the shareholder was entitled to do so;[1] and the same principle has been, in effect, ruled by Mr. Circuit Judge Dillon, reversing Treat, District Judge. Here a director, who had never actively participated in the affairs of the company, bought up at a discount claims against it, sued the company upon them, obtained a judgment by default, and proved for the full amount of his claim in bankruptcy. It was held that this could be done. The judgment, not being impeached for fraud, was held conclusive of his rights as a creditor.[2] The *directors* of a corporation occupy a trust relation toward its creditors, under the operation of the doctrine that its assets are a *trust fund* for its creditors, of which assets they are the custodians; and this, under the best conceptions, will operate to restrain them from speculating in this way out of the misfortunes of its creditors,[3] at least until their trust relation is determined, by the appointment of a receiver or otherwise. It follows that where a proceeding is instituted against a director, under a statute, to enforce his personal liability,—as, for instance, for concurring in the contracting of corporate debts before the capital stock has been paid in and the certificate thereof filed in the public office,[4]—he cannot be permitted to buy up judgments or other evidences of indebtedness of the corporation, knowing it to be insolvent, and to use the same as an offset. In such a case a judgment will go against him for the full amount, notwithstanding his plea of such an offset.[5] Even where the rule of the jurisdiction allows a stockholder to plead, by way of offset, a debt due him from the corporation, a director in such a case will not be permitted to establish an offset for more than the amount actually paid out by him in purchasing the debt of the corporation.[6]

[1] Re Humber Iron Works Co., L. R. 8 Eq. 122.

[2] Walker *v.* Stillwell (MS.).

[3] *Post*, ch. 146.

[4] N. Y. Man. Act of 1848, ch. 40, § 10.

[5] Bulkley *v.* Whitcomb, 121 N. Y. 107; *s. c.* 24 N. E. Rep. 13.

[6] Bulkley *v.* Whitcomb, *supra*.

§ 3799. And for Stronger Reasons a Stranger may do so.— If a shareholder may do this, upon clearer reasons a stranger may. Thus, where a *billholder* of an insolvent bank sought to coerce payment from the stockholders, it was no defense that he had bought the bills of a broker, under an agreement to keep them out of circulation for a time, he not having had notice, at the time, that they were improperly issued.[1] So, in a proceeding by motion for an execution against a stockholder under a statute, evidence offered by the defendant to show that the judgment creditor had purchased his demand at a discount after the insolvency of the corporation, was held to be wholly irrelevant and erroneously admitted.[2]

§ 3800. Company may Set Off Calls against Its Own Debt. The principle which operates to deny the right of set-off to a shareholder who is also a creditor is designed for the general *benefit of the creditors*, and to prevent the shareholders from getting an advantage over them in the distribution,— the rule being that they are entitled to be paid first in the distribution, and the shareholders not at all, unless there is something remaining after the creditors are paid.[3] It is, therefore, clearly a rule that does not, so to speak, work both ways. It may clearly be relaxed by the court superintending the administration, so as to allow a debt due by the company to the shareholder, to be set off as against calls due from the shareholder to the company, and this may be appropriately done when the shareholder is insolvent; otherwise he would

[1] Grew *v.* Breed, 10 Met. (Mas.) 569.

[2] Coquard *v.* Prendergast, 35 Mo. App. 237. So, it was held in England prior to the Judicature Act of 1875, that the mere intervention of a winding-up proceeding will not cut off the right of set-off of a debtor of the company who is not a shareholder. Anderson's case, L. R. 3 Eq. 337. See, also, Mersey Steel &c. Co. *v.* Naylor, 9 Q. B. Div. 667. Nor was it essential that both debts should have been actually due, so as to create a right of set-off, before the winding-up order was made. Ex parte James, L. R. 8 Eq. 225. But this is contrary to the general American doctrine, expressed *ante*, § 3786. For a case proceeding on the view that a statute allowing a set-off to a *stockholder* does not operate in his favor as a billholder, see Dunlap *v.* Smith, 12 Ill. 399, 401.

[3] *Ante*, § 3545.

be allowed to pay nothing as a shareholder and yet to get a dividend as a creditor.[1] So, it has been held in England that a company may, even after winding-up proceedings have commenced, set off a debt due to it by a shareholder, for calls, against a debt due by it to the shareholder; and, applying the familiar rule that an evidence of debt not negotiable can only be assigned subject to existing equities, it has been held that a shareholder cannot, after the commencement of a winding-up proceeding, *assign* a debt due to him by the company so as to displace the company's right of set-off. Thus, a company commenced to be wound up in December, 1866. On March 1, 1867, a shareholder assigned five debentures of the company, and notice of the assignment was given to the official liquidator on the same day. In June, 1867, and Febuary, 1868, calls were made on the assignor for amounts exceeding what was due on the debentures. The *calls not having been paid*, it was held that the assignee was not entitled to prove against the company on the debentures.[2] The question is sometimes involved in the rights of creditors who hold successive *liens* upon the property of the corporation. In such cases one creditor cannot invoke the aid of a court of equity to have a judgment against the corporation, held by a stockholder, set off against his liability for unpaid calls, merely for the purpose of satisfying the judgment and getting its lien out of his way, where it appears that to order the set-off might operate to the prejudice of other creditors,— as, for instance, where the stockholder is not shown to be insolvent.[3]

[1] See the reasoning of Mr. District Judge Knowles in Gilchrist *v.* Helena &c. R. Co., 49 Fed. Rep. 519, where this principle is recognized.

[2] Ex parte Mackenzie, L. R. 7 Eq. 240.

[3] Gilchrist *v.* Helena &c. R. Co., 49 Fed. Rep. 519. In an English case the articles of association provided that a sum of money was to be paid to the promoter, he indemnifying the directors against all costs, charges, and expenses incurred previous to the allotment of the shares. Seventeen debentures of £100 each were issued to the promoter in payment of this sum. The promoter did not pay all the costs and expenses in respect of which he was to indemnify the directors; and such costs and expenses were, to the amount of about £208, proved in the winding up of the com-

§ 3801. Setting off Unpaid Dividends against Debts of the Corporation. — This subject has already been considered, with the conclusion that the dividend, when declared and payable, becomes a *debt* due by the corporation to the shareholder;[1] and that while the corporation is a going concern, the shareholder may set off his *unpaid dividend*, against a *call* which is made upon him, because both are debts due and presently payable, and the *mutuality* is complete.[2] It would follow that the power of the corporation to make a *by-law* providing for such a set-off would exist as a natural incident of its power to make any reasonable by-law.[3] But whether this right of set-off exists after the company becomes *insolvent* may present a different question, depending on different theories as to a dividend. There is a theory that, after a dividend has been declared, and the time has arrived at which it becomes payable, according to the resolution of the directors declaring it, the money is held by the corporation for its stockholders respectively, as their *trustee* or *bailee*, — a theory which necessarily excludes any right of set-off.[4] But even if it were regarded as such a *trust fund*, and not as an ordinary *debt*, it is believed that a court of equity might properly impound it in satisfaction of the liability of the shareholder for further calls, in case it should appear that he was otherwise *insolvent*. Under no theory is the shareholder entitled to set off, against his debt to the company, a dividend which may afterwards come to him *in liquidation;* because it never can be known what such a dividend will be, until all the debtors have paid in what they owe, and an account is taken. But, upon payment of all calls which have become due, he is entitled to receive dividends at the same time and at the same rate with other creditors.[5]

pany. It was held that the company was entitled to set off one-seventeenth part of the sum so proved, against the amount due on each debenture. Re South Blackpool Hotel Co., L. R. 8 Eq. 225.

[1] *Ante*, §§ 2126, 2134.

[2] See on this subject, Whittington *v.* Farmers' Bank &c., 5 Har. & J. (Md.) 489; *ante*, § 2133.

[3] Bellevue Bank *v.* Higbee, 4 Ohio Circ. Ct. 222.

[4] *Ante*, § 2131.

[5] Re Overend, L. R. 1 Ch. 528.

§ 3802. Where the Indebtedness to the Stockholder has Collateral Security. — The reason which disallows the right of set-off is stronger where the indebtedness of the corporation to the stockholder whose liability is sought to be subjected, has collateral security. In such a case, the proceeding being in equity in behalf of all the creditors, it has been held proper to require the stockholder to pay the amount of his unpaid subscription and *surrender the collateral securities*, — allowing him thereafter to participate in the fund ratably with the other creditors.[1] Where the action was in the nature of an action at law to enforce the statutory liability of the stockholders, and it appeared at the trial that they held collaterals as security for a note which, when paid, was to operate as the satisfaction of a judgment obtained by them against the corporation, — it was held that judgment could not be given, ordering the plaintiff's claim against the corporation to be collected from such collaterals.[2]

§ 3803. Shareholder can only Assign Debt of Company Subject to Right of Set-off. — From the preceding sections, it follows that, after the commencement of winding-up proceedings, a shareholder can only assign a debt due to him from the company, subject to a right of set-off by the company, of all calls which may be made subsequently to the assignment and previously to the payment of the debt.[3] It has been held in England that where a contributory, who is also a creditor of a company which is being wound up, becomes bankrupt, or executes a creditor's deed under the Bankruptcy Act, after the commencement of the winding up, the debt must be set off against the calls, whether the claim be made in the bankruptcy or in the winding up. And if the contributor had, before his bankruptcy, assigned his debt to a third party, the assignee will stand in the same position as the contributory would have done as to the right of set-off.[4]

[1] Thompson *v.* Reno Savings Bank, 19 Nev. 103; *s. c.* 3 Am. St. Rep. 797.

[2] Agate *v.* Sands, 8 Daly (N. Y.), 66; *s. c.* affirmed, 73 N.Y. 620.

[3] Re China Steamship Co., L. R. 7 Eq. 240.

[4] Re Universal Banking Corp., L. R. 5 Ch. 492.

§ 3804. Policy-holders cannot Set off Loss against Liability on Premium Note.—If a stockholder in an insolvent insurance company cannot buy up a loss and set it off against his liability as a contributory, by parity of reasoning, if he himself is a policy-holder, and has suffered a loss, he cannot set off his loss against his own liability. Thus, in an action by a mutual insurance company against one of its members, on his premium note, the defendant pleaded as a set-off a loss which he had sustained on a stock of goods embraced in his policy of the plaintiff company. It appeared that a great and disastrous fire had occurred, in consequence of which it was admitted that the funds of the company would be insufficient to pay all its losses. It was held that the set-off could not be allowed.[1] The same principle was applied and enforced in a case in New York, where the receiver of an insolvent mutual marine insurance company brought suit against a member of the company on several premium notes, against which the defendant endeavored to set off an adjusted loss due to him, from the company, on one of his ships.[2] The same principle was applied by Mr. Circuit Judge Drummond, in a case where, after an insurance company had been adjudicated bankrupt, he held that the right of set-off did not exist, basing his decision chiefly on the ground of a want of mutuality in the obligations sought to be set off against each other.[3] But this wholesome decision was reversed on appeal by the Supreme Court of the United States in an inexplicable decision,[4] and one which seems to proceed in the very face of its previous holding in a leading case.[5]

[1] Hillier *v.* Allegheny County Ins. Co., 3 Pa. St. 470; *s. c.* 45 Am. Dec. 656.

[2] Lawrence *v.* Nelson, 21 N. Y. 158.

[3] Scammon *v.* Kimball, 5 Biss. (U. S.) 431. This decision is printed in full by Mr. Myer in his Federal Decisions, although it was reversed on appeal.

[4] Scammon *v.* Kimball, 92 U. S. 362.

[5] Sawyer *v.* Hoag, 17 Wall. (U. S.) 610.

Article II. Under Particular Statutes.

Section
3809. Under section 10 of New York Manufacturing Law.
3810. Under the New York Business Companies Act of 1875.
3811. In a proceeding by motion under Missouri statute for execution against the stockholder.
3812. Under Maine statute.
3813. Under Georgia statute.

§ 3809. Under Section 10 of New York Manufacturing Law.—This statute reads as follows: "All the stockholders of every company incorporated under this act shall be severally individually liable to the creditors of the company in which they are stockholders, to an amount equal to the amount of stock held by them, respectively, for all debts and contracts made by such company, until the whole amount of capital stock fixed and limited by such company shall have been paid in."[1] Under this section it is held that a stockholder cannot, in an action at law against him by a creditor of the corporation, set off a claim which he may have against the corporation, if he himself is in debt to the corporation upon his stock in a larger amount than such claim; otherwise he can.[2] The meaning of the rule is, that if a creditor can find a stockholder to whom the corporation is indebted beyond the amount which the creditor owes the corporation for his stock, he cannot recover of him at law, but must resort to equity for an accounting and adjustment of the liability of all the stockholders.[3] The rule is regarded as necessary to put stockholders on an equal footing with other creditors.

§ 3810. Under the New York Business Companies Act of 1875.—In a decision in the court of common pleas of the city and county of New York, there is a very clear statement of the law in that State on this subject, in a case arising under the so-called New York Limited Liability Act of 1875, some-

[1] N. Y. Laws of 1848, ch. 40.

[2] Wheeler *v.* Millar, 90 N. Y. 353; Mathez *v.* Neidig, 72 N. Y. 100. See also Agate *v.* Sands, 73 N. Y. 620; affirming *s. c.* 8 Daly (N. Y.), 66; Pfohl *v.* Simpson, 74 N. Y. 137, 142; Garrison *v.* Howe, 17 N. Y. 458; Re Empire City Bank, 18 N. Y. 199, 227.

[3] Garrison *v.* Howe, *supra.*

times called the New York Business Companies Act of 1875.[1] It is there stated that the construction of the Act of 1875, in regard to the remedy of the creditor and the right of set-off of the stockholder when the creditor proceeds at law, is the same as that of the Manufacturing Act of 1848. That construction is, that the creditor has the option of two remedies: 1. He may bring an action in equity for a general accounting, in which all the stockholders and creditors should be parties. In such a proceeding all the persons interested would be before the court; and the court, upon adjusting the merits of the controversy, would require that all stockholders should pay in the amount due in respect of their shares, and that all creditors, including such as might be stockholders, should receive proportionate dividends. 2. The directors may proceed at law against any stockholder, under the special right to sue conferred by statute, and hold the stockholder liable up to the amount of his share subscription. But it has long been settled in that State that, where the creditor chooses this remedy, it is open to the stockholder to set up as a defense that he himself is a creditor of the corporation.[2] The theory of this rule is, roughly speaking, that the stockholder ought to have as good a right to defend on the ground that the corporation is in debt to him, as the creditor has to single the stockholder out and sue him on the ground that the corporation is in debt to the creditor. "I see no reason," said Church, C. J., "why the defendant, as a creditor, does not occupy as favorable a position as the plaintiff; and there is no justice in permitting the latter to recover money to which the former has an equal claim, in an action where it cannot regularly be ascertained but that other portions of the aggregate fund which are accessible to the plaintiff are sufficient to satisfy his demand."[3]

[1] New York Laws 1875, ch. 611.

[2] Richards *v.* Kinsley, 14 Daly (N. Y.), 334, 338; referring to Briggs *v.* Penniman, 8 Cow. (N. Y.) 387; *s. c.* 18 Am. Dec. 454; Garrison *v.* Howe, 17 N. Y. 458; Mathez *v.* Neidig, 72 N. Y. 100; Wheeler *v.* Millar, 90 N. Y. 353.

[3] Mathez *v.* Neidig, 72 N. Y. 100, 106.

§ 3811. In a Proceeding by Motion, under Missouri Statute, for Execution against the Stockholder.—In a proceeding under the Missouri statute,[1] by motion for execution against a stockholder, the stockholder is entitled to offset against his liability any demands which he may have against the corporation.[2] In like manner, it has been held that stockholders who owe the company for their subscription may, nevertheless, obtain judgment against the corporation for any balance due them, and then, as judgment creditors of the corporation, may proceed under the statute against other stockholders.[3] Under this statute the liability of a stockholder to execution accrues on the return of *nulla bona* on an execution against the corporation, and cannot be cast off by a *transfer* of stock, or by acquisition of a claim against the corporation; therefore, the fact that, at the date of the motion, the corporation owes the stockholder more than it owes the creditor, is no defense to the latter's motion for execution against the former.[4]

§ 3812. Under Maine Statute.—While it is conceded in this State that, where the object of the proceeding is to wind up the affairs of the corporation, assess all its shareholders, and distribute its assets to its creditors, no right of set-off exists,[5] yet the law of this State has been placed in such an incongruous position by a statute,[6] that, in an action at law by the assignee of an insolvent corporation against a stockholder to recover an unpaid balance upon his share subscription, the stockholder has the right to set off any debt which he may hold against the corporation.[7]

[1] Rev. Stat. Mo. 1879, § 736; *Id.* 1889, § 2517.

[2] Jerman *v.* Benton, 79 Mo. 148, 155; Merchants' Ins. Co. *v.* Hill, 12 Mo. App. 148, 149; Webber *v.* Leighton, 8 Mo. App. 502.

[3] Schaeffer *v.* Phœnix Brewery Co., 4 Mo. App. 116.

[4] Coquard *v.* Prendergast, 35 Mo. App. 237.

[5] McAvity *v.* Lincoln Pulp &c. Co., 82 Me. 504; Appleton *v.* Turnbull, 84 Me. 72.

[6] Rev. Stat. Me., ch. 46, § 48.

[7] Appleton *v.* Turnbull, *supra.* Compare Grose *v.* Hilt, 36 Me. 22.

§ 3813. Under Georgia Statute.—It has been held that a *bona fide judgment* debt of a stockholder against the company in which he holds stock may be set off by him, in equity, against a suit to make him individually liable in proportion to his stock. Such judgment may be *attacked for fraud;* but the facts on which the charge of fraud is made must be averred in the pleadings, and proved to the satisfaction of the jury on the hearing.[1]

[1] Boyd *v.* Hall, 56 Ga. 563.

CHAPTER LXXI.

CONTRIBUTION AMONG STOCKHOLDERS.

SECTION
3816. Shareholder paying more than his proportion entitled to contribution.
3817. But only after exhausting remedy against corporation.
3818. Right given by statute.
3819. Theories of contribution in winding-up proceedings.
3820. Extent to which shareholders liable to contribute as among themselves.
3821. Whether interest recoverable in a suit for contribution.
3822. Form of the decree enforcing contribution.

SECTION
3823. Cases denying the right of contribution without reason.
3824. Cases denying contribution with good reason.
3825. Voluntary payment does not create right of contribution.
3826. No contribution where the aggregate debts exceed the liabilities of all the stockholders.
3827. Liability for contribution under special contracts.
3828. Actions for contribution against non-resident stockholders.
3829. Contributions in actions at law.

§ 3816. Shareholder Paying More than his Proportion Entitled to Contribution.—There is no doubt that a stockholder who has been compelled to pay more than his proportionate share of the debts of the company may maintain an action against his co-stockholders for a contribution.[1] This right of contribution arises in any case in favor of the stockholder who has paid out more than *his proportionate share* of the liability resting upon the aggregate stockholders, in a

[1] Redington *v.* Cornwell, 90 Cal. 49; *s. c.* 27 Pac. Rep. 40; Allen *v.* Fairbanks, 45 Fed. Rep. 445; Aspinwall *v.* Torrance, 1 Lans. (N. Y.) 381; Farrow *v.* Bivings, 13 Rich. Eq. (S. C.) 25; Gray *v.* Coffin, 9 Cush. (Mass.) 192; Stewart *v.* Lay, 45 Iowa, 604, 614. See Sutton's case, 3 De Gex & Sm. 262. Contribution between A. and B., where A. holds stock on joint account of himself and B.: Stover *v.* Flack, 30 N. Y. 64. It has been held, under particular circumstances, that although members of the corporation who have retired from it may be liable to its creditors, yet money paid by them after retirement can be recovered by them from the *new members*. Savage *v.* Putnam, 32 Barb. (N. Y.) 420.

legitimate and fair effort to protect his own interest in the corporate property,[1]— and this, whether the liability of the stockholders is for a proportionate share of the corporate debts,[2] or whether the charter or governing statute makes them jointly and severally liable, and the liability is enforced against the particular stockholder by an action at law.[3] This statement will disclose the difference between the remedy at law against a single stockholder, and the case where a single creditor is required to bring a bill in equity against all the stockholders and on behalf of all the creditors. In the former case, the stockholder proceeded against may be compelled to respond to the extent of his personal liability, although it may be in excess of his just proportion as between him and the other stockholders,— in which case he will be left to secure contribution from them by a suit in equity prosecuted at his own expense;[4] whereas, in the latter case, complete justice is done in a single action, by ratable assessments upon all the stockholders, and by a ratable distribution among all the creditors. Statutes exist, like that in California, where each stockholder is liable to a ratable proportion of the corporate debts. Here the rule has been, in order to determine how much any one stockholder is liable to pay to the particular creditor who brings the action against him, to find the whole amount of the indebtedness of the corporation created while he was a stockholder, and to render judgment against him to the extent of this amount, if necessary to satisfy the judgment recovered by the plaintiff against the corporation. If, in this way, the particular stockholder finds that he has paid more of the debts of the corporation than his proportionate share, he is, it is said, entitled to maintain an action for contribution against his co-stockholders.[5]

[1] Redington *v.* Cornwell, 90 Cal. 49.

[2] *Ibid.*

[3] Judson *v.* Rossie Galena Co., 9 Paige (N. Y.), 598; *s. c.* 38 Am. Dec. 569.

[4] See, for illustration, Larrabee *v.* Baldwin, 35 Cal. 155, 168, 169.

[5] *Ibid.*

§ 3817. But only after Exhausting Remedy against Corporation. — But the right of a stockholder thus to sue is subject to the same condition precedent which attaches to the right of a creditor, or his representative, to sue one or more stockholders for a debt of the corporation;[1] he must first have exhausted all the property of the company.[2] And so, where the governing statute requires the judgment creditor of the corporation first to demand payment of the corporation, and if the corporation fails to satisfy his execution, then to levy it upon the property of the officers of the corporation; and allows him to resort to the property of the general stockholders only in case of failure thus to secure satisfaction,[3]—a stockholder cannot enforce contribution against the other members of the company, for money voluntarily paid by him in discharge of a corporate debt, unless a previous demand has been made on the corporation, and unless it appears that there is no property of the officers from which satisfaction of the debt can be obtained.[4]

§ 3818. Right Given by Statute. — In several of the States the right is given by express statute.[5] This right, under the Massachusetts statute of 1808, was denied in that State, on grounds which do not reflect credit upon the judges of that day, although the English chancery system had not yet been introduced by statute.[6] As often happens where rights are denied through the narrow technicality of lawyers, and through an habitual indifference to justice, the Legislature of that State interposed and changed the rule; so that, under a statute[7] making the stockholders in certain corporations personally liable for its debts under certain contingencies, any stockholder who had himself paid a debt of the corporation

[1] *Ante*, § 3351.

[2] Gray *v.* Coffin, 9 Cush. (Mass.) 192, 208.

[3] See Denny *v.* Richardson, 4 Gray (Mass.), 274.

[4] Cary *v.* Holmes, 2 Allen (Mass.), 498.

[5] Lowry *v.* Inman, 46 N. Y. 119; Sayles *v.* Bates, 15 R. I. 342; Brinham *v.* Wellersburg Coal Co., 47 Pa. St. 43.

[6] Andrews *v.* Callender, 13 Pick. (Mass.) 484.

[7] Mass. Rev. Stat., ch. 38, § 16.

might enforce contribution from his associates by a bill in equity against all the stockholders who were solvent and within the jurisdiction.[1] A statute of Rhode Island, giving the right of contribution, is as follows: "Any stockholder who shall, whether voluntarily or by compulsion, pay any debt of the company for which he is made liable by the provisions of this chapter, may recover the amount so paid in an action of the case against the company, in which action the property of the company only shall be liable to be taken, and not the person or property of any stockholder of the company; or the person who shall have so paid such debt of the company may proceed, in the supreme court in equity, for contribution, against any one or more of the stockholders who were originally liable with him for the payment of said debt, and may recover against each of them their just and equitable proportion thereof." It was held that the words "stockholders originally liable" included all stockholders who were liable for the debt *before* it was paid by the stockholders suing for contribution; and, therefore, that all persons who were stockholders *when proceedings were begun* to enforce the liability, were proper contributors.[2] Perhaps the conclusion may be extracted from decisions of the Supreme Court of Pennsylvania, that where the governing statute at once declares the liability of the stockholders, prescribes the remedy for enforcing the liability, and also the mode of enforcing contribution against the other stockholders, such statutory mode of enforcing contribution is exclusive, and does not leave the road open to a remedy in equity,[3] or to an ordinary action of *assumpsit* against other stockholders.[4] But the better view would seem to be that this is not a case where the statute creates a right and prescribes the remedy, and where the remedy prescribed by the statute would therefore not be exclusive.[5] The remedy of the stockholder against whom

[1] Cary *v.* Holmes, 16 Gray (Mass.), 127.

[2] Sayles *v.* Bates, 15 R. I. 342, 344.

[3] Brinham *v.* Wellersburg Coal Co., 47 Pa. St. 43.

[4] O'Reilly *v.* Bard, 105 Pa. St. 569.

[5] *Ante*, §§ 3020, 3054.

judgment is recovered and enforced, under the statute of Pennsylvania here referred to,[1] is to take an *assignment of the judgment*, and to enforce execution against stockholders who were parties defendant in the action. He cannot bring *assumpsit* against stockholders who were not parties, to enforce contribution.[2]

§ 3819. Theories of Contribution in Winding-up Proceedings. — We have seen that the right of shareholders to contribution *inter se*, and to have their mutual equities adjusted without a multiplicity of suits, is the chief ground on which equity assumes jurisdiction of suits to charge shareholders;[3] that in such a suit each shareholder may claim a contribution from the others,[4] and that their co-stockholders, so far as practicable, be made parties for this purpose.[5] Where the liability of the shareholders is assimilated to that of *partners*, — and the writer thinks this rule will hold good in all cases, — contribution is decreed upon the principles which obtain in equity in winding up a partnership. If, after applying the corporate assets, there are still outstanding liabilities, the stockholders must contribute in proportion to their shares; if there is a surplus, it will be divided among them in like proportion.[6] The theory of equity, applied in many cases even to an individual superadded liability, is that such a liability, created by statute, is *several*, and yet for the common benefit of all the creditors, and not under the control of the corporation, — and that, as between the stockholders, it is to be proportioned to the amount of stock held by each.[7] In such cases the right of contribution is said to grow out of the organic relation existing among the stockholders, as between them and the creditors. Each stockholder is severally liable

[1] Pa. Act of April 7, 1849, and its pplements.

[2] O'Reilly *v.* Bard, 105 Pa. St. 569.

[3] *Ante*, § 3432.

[4] Matthews *v.* Albert, 24 Md. 527.

[5] Masters *v.* Rossie Lead Mining Co., 2 Sandf. Ch. (N. Y.) 301; Hadley *v.* Russell, 40 N. H. 109; Umsted *v.* Buskirk, 17 Ohio St. 113.

[6] Erickson *v.* Nesmith, 46 N. H. 371.

[7] Umsted *v.* Buskirk, 17 Ohio St. 113.

to all the creditors; but as between themselves, each stockholder is bound to pay in proportion to his stock. This is the reason which supports the conclusion that, where a creditor's bill is brought, it should proceed on behalf of all creditors, and that the stockholders whose liability is sought to be enforced have the right to insist that their *co-stockholders shall be made parties* for the purpose of a general accounting, and to enforce from them contribution in proportion to their several holdings of shares in the corporation.[1]

§ 3820. Extent to Which Shareholders Liable to Contribute as among Themselves. — Where the shareholders stand liable in equal degrees, the proportion which one of them must contribute to another who has been compelled to pay a debt of the corporation is, *what the complainants have paid for him.* This, it seems, is what he would have been obliged to pay if all the stockholders, resident and non-resident, solvent and insolvent, had paid their ratable proportions.[2] Where, however, the shareholders stand *liable in different degrees*, then contribution is to be enforced according to their several degrees of liability. The manner of adjusting the equities of shareholders under the English Winding-up Act, 1848,[3] was thus stated by Lord Chancellor Cottenham: "When the master has placed on the list all the persons found by evidence to have been members of the company, he then commences the process of distributing the payment of the losses; but it is not to be assumed that a person whose name is placed on the list becomes liable to pay an equal share of those losses. There is a general loss to be defrayed, but the directors of the company may, in a greater or less degree, have added to that loss by their mismanagement. Some of the subscribers may have sanctioned or adopted those acts of mismanagement; but the

[1] *Ibid.* That all stockholders must be made *parties* in a creditors' bill, for the purpose of enforcing a ratable contribution, see Hadley v. Russell, 40 N. H. 109; *ante*, § 3493. That they need not be made *parties*, see *ante*, § 3499.

[2] See, as supporting the text in part, Allen v. Fairbanks, 45 Fed. Rep. 445; 9 Rail. & Corp. L. J. 443.

[3] 11 & 12 Vict., ch. 45.

body of the shareholders are not liable to contribute to the payment of expenses so improperly contracted, and it is for the master to ascertain and distribute the contribution according to the degrees of liability."[1]

§ 3821. Whether Interest Recoverable in a Suit for Contribution. — This question has been answered in the affirmative by a learned Federal judge, on the ground that the stockholders suing for contribution have been compelled to pay money for the defendant stockholder which he ought to have paid, — taking the view that it is not material that he may not have actually *known* of the circumstances requiring him to make the payment at the time.[2]

§ 3822. Form of the Decree Enforcing Contribution. — We have already had occasion to consider the form of the decree where the proceeding is to subject the liability of the stockholders.[3] But in one case the decree subjected all the shareholders to the payment of the debt, with *leave to apply* to enforce contribution among themselves.[4]

[1] Ex parte Mansfield, 2 Macn. & G. 57, 67.

[2] Allen *v.* Fairbanks, 45 Fed. Rep. 445, 447. "Interest," said Wheeler, J., "is recoverable generally upon advances of money (Liotard *v.* Graves, 3 Caines (N. Y.), 226; Sedgw. Dam. 380); and upon money paid by a surety without demand (Ilsley *v.* Jewett, 2 Met. (Mass.) 168). Being compelled to pay money for the defendant was the same, in effect, as having it detained by him, for which interest is recoverable. Ekins *v.* East India Co., 1 P. Wms. 395; Wood *v.* Robbins, 11 Mass. 504; *s. c.* 6 Am. Dec. 182. Upon these principles, interest appears to be chargeable upon the respective amounts paid for the defendant from the time of payment."

[3] *Ante*, § 3536, *et seq.*

[4] Masters *v.* Rossie Lead Mining Co., 2 Sandf. Ch. (N. Y.) 301. There is a *direction* by the Supreme Court of Tennessee, for the guidance of the chancellor, in a proceeding to wind up an insolvent bank, to the effect that "any parties against whom judgments have been rendered, who are assignees of any judgments rendered in favor of note-holders, may have the judgments against them extinguished *pro tanto* by said assigned judgments, in the discretion of the chancellor." Marr *v.* Bank of West Tennessee, 4 Lea (Tenn.), 578, 596. The writer does not quite get hold of the meaning of this direction, — whether it is intended to allow a *set-off* in favor of stockholders, which would be contrary to the principles of equity, or whether it is intended to vest in the chancellor a discretion of allowing an *adjustment* without requiring them to pay to the receiver what is due them as judg-

§ 3823. Cases Denying the Right of Contribution without Reason. — A considerable number of cases are found which deny the right of contribution; and some of them seem to illustrate the fact that lawyers who, in their professional careers, are half of the time on the wrong side of controversies, habituate themselves to reasoning on technical lines, and retain the same indifference to justice when they find themselves promoted to the judicial bench. One court has held that where a stockholder of a corporation became a *surety* on a note executed by the corporation, at the request of the other stockholders, he could not recover of them their proportion of what he had been compelled to pay.[1] Where a corporation for manufacturing purposes was dissolved, leaving the buildings commenced by the corporation unfinished and liable to injury from the weather, one of the stockholders or part owners, who went on and completed the building without the consent of the other owners, was denied contribution from the others.[2]

§ 3824. Cases Denying Contribution with Good Reason. — But there are many cases which deny the right of contribution among shareholders for obviously good reasons. If a shareholder has been obliged to pay a debt of the corporation *in consequence of his own wrong*, he obviously ought not to be allowed to recoup himself upon the shareholders who are innocent. If, therefore, the *officers* of the corporation have been compelled to pay its debts in consequence of their own *defaults* in failing to comply with the requirements of statutes, they cannot compel the shareholders, who are not guilty of any wrong, to divide this loss with them.[3] So, if a member of a corporation causes it to contract a debt in excess of the amount permitted to it by its articles of incorporation, without the consent of the other stockholders, and himself pays the debt, he cannot compel contribution beyond the sum limited.[4] So, if the trustees of an incorporated seminary advance money and contract

ment debtors before getting their dividend with other creditors. So much of the direction as submits it to the *discretion* of the chancellor is intelligible only on the latter theory.

[1] Larson *v.* Dayton, 52 Iowa, 597.

[2] Skinner *v.* White, Hopk. Ch. (N. Y.) 107.

[3] Stone *v.* Fenno, 6 Allen (Mass.), 579.

[4] Haldeman *v.* Ainslie, 82 Ky. 395.

debts without any authority, expressed or implied, to incur such liabilities, they have no right to compel a contribution from the associates at large to reimburse them for such advances.[1]

§ 3825. Voluntary Payment does not Create Right of Contribution. — It has been held that a member who *voluntarily pays* a company debt for which the members are, by statutes, personally liable, has no claim, under those statutes, or on the other members for contribution.[2] This has been held to be especially true where the member making the voluntary payment did not wait until the creditor had exhausted his statutory remedy by proceeding, in the statutory mode, against the property of the corporation, and against that of the officers, who stood liable before the general stockholders; otherwise a stockholder might compel his fellow-members to contribute to the payment of debts of the corporation for which they might never be held liable, and which would never be enforced against them.[3] Perhaps a juster view of this question is that where a stockholder comes forward and pays a debt of the corporation in order to protect his own interest in the corporation, this is not such a voluntary or officious payment as will deprive him of a right of contribution against his co-stockholders.[4]

§ 3826. No Contribution where the Aggregate Debts Exceed the Liabilities of All the Stockholders. — Where the aggregate debts of the corporation exceed the aggregate liabilities of all the stockholders, no question of contribution can arise, — at least until the aggregate debts, by the operation of the statute of limitations or otherwise, have been reduced *below* the aggregate liabilities of the stockholders. Until such time,

[1] Shibley *v.* Angle, 37 N. Y. 626. A case unintelligible to the writer, where contribution was denied, is Hopkins *v.* Whitesides, 1 Head (Tenn.), 31.

[2] Andrews *v.* Callender, 13 Pick. (Mass.) 484. Compare Skinner *v.* White, 1 Hopk. Ch. (N. Y.) 107; *ante*, § 3817.

[3] Cary *v.* Holmes, 2 Allen (Mass.), 498, 501.

[4] Redington *v.* Cornwell, 90 Cal. 49; *s. c.* 27 Pac. Rep. 40.

a court of equity, in which a creditors' bill is pending, will not be required to delay the proceeding and postpone the rights of the creditors, for the purpose of making other stockholders parties, to the end that there may be a ratable contribution and adjustment between such stockholders and those who have been made parties.[1]

§ 3827. Liability for Contribution under Special Contracts. Even where no right of contribution may exist under the theory of law or equity prevailing in the particular jurisdiction, yet where the members *agree, in writing,* to reimburse each other to the extent of such sums as they may respectively be obliged to pay, in consequence of indorsing the notes of the corporation, they have a remedy for contribution on such agreement.[2] And where a person not a stockholder has, at the request of stockholders, become a *surety,*—not for stockholders, but *for the corporation,*—this, it has been held, does not create a liability on the part of the stockholders to indemnify him in the event of being compelled to pay the debt of the corporation. The imperfect reason given for the conclusion was, that such a request involved no promise of indemnity and no undertaking of any kind on the part of the stockholders.[3] The court overlooked the fact that the stockholders are in a large sense the corporation, and that a request by the stockholders to a stranger that he will become surety for a debt of the corporation is in a moral and a just sense a request that he will become surety for *their own debt.* Where stockholders become *co-sureties for the corporation,* a right of contribution arises among themselves, provided the circumstances are such as would give such a right as among sureties in an ordinary case. Thus, where the five solvent stockholders of a corporation executed and delivered to a creditor thereof their joint and several promissory note for money loaned to and

[1] Mason *v.* Alexander, 44 Ohio St. 318; *s. c.* 7 N. E. Rep. 435.

[2] Andrews *v.* Callender, 13 Pick. (Mass.) 484. For the construction and effect of such an agreement for contribution, see North *v.* Brace, 30 Conn. 60. See also Bainbridge *v.* Gehring, 3 W. Va. 240.

[3] Larson *v.* Dayton, 52 Iowa, 597.

used by the corporation, it was held that they became thereby *co-sureties* for the company; but as between themselves, each was liable to pay one-fifth of the whole and no more, and to make equal contributions to one of their number paying the whole note at maturity, without regard to their relative amounts of stock. They signed as individuals, not as stockholders or trustees, and the charter did not make them partners.[1] Where a majority of stockholders had by the charter the right to order the winding up and liquidation of the affairs of the company, and the majority of them signed an obligation to pay their proportion of the outstanding debts, it was held they could not be released from the obligation on the ground that it was not binding upon any of the stockholders until *all had signed* it.[2]

§ 3828. Actions for Contribution against Non-resident Stockholders. — As the stockholders in many great American corporations are frequently scattered all over the country and reside in different States, the right of contribution would be very imperfect if the stockholder who resides in the jurisdiction of the corporation or elsewhere, and who has been compelled to pay more than his ratable share of its debts, could not maintain a bill in equity for a contribution against any of his co-stockholders, in whatever State or jurisdiction he might find them. A just view of this question allowed a stockholder of a Missouri corporation, residing in that State, who had been compelled in a proceeding in that State,[3] to pay more than his ratable proportion of the debts of the corporation, to maintain a bill in equity in the United States Circuit Court in Vermont, against a stockholder resident in that State, for a contribution.[4] But a decision of the United States Circuit Court for the District of Maryland strikingly illustrates the extent to which the shallow and trivial conception that our American States are *foreign countries* in respect to each other

[1] Coburn *v.* Wheelock, 34 N. Y. 440.

[2] Green *v.* Relf, 14 La. An. 841.

[3] The proceeding was in the much cited case of Skrainka *v.* Allen, 7 Mo. App. 435; *s. c.* 76 Mo. 384.

[4] Allen *v.* Fairbanks, 45 Fed. Rep. 445; *s. c.* 9 Rail. & Corp. L. J. 433.

sticks in the minds of lawyers, and the gross injustice which they are willing to do in giving effect to it. Certain stockholders of a Rhode Island corporation, who resided in that State, were compelled to pay a judgment against the corporation, under a statute of that State which made the stockholders of the corporation liable for its debts in case a certain prescribed annual certificate should not be filed in a public office. It was held that these stockholders could not maintain a suit in equity, in a Federal court in Maryland, to procure contribution from certain other stockholders resident in that State. The court proceeded on the narrow and untenable ground that the provisions of the statute, being *penal*, were not enforceable outside of the State enacting them.[1] And yet the Maryland stockholders enjoyed the benefaction of the laws of Rhode Island, which enabled them to possess corporate privileges in that State in common with her own citizens; they could vote at elections of the corporation, and exercise, in proportion to their holdings of its capital stock, the same power in managing the affairs of the corporation that the Rhode Island stockholders could exercise. In short, they exhibited the position of stockholders who had voluntarily made themselves subject to the Rhode Island law, who had assumed the duties and subjected themselves to the liabilities which it imposed, and who were *equally guilty* with the Rhode Island stockholders; and a court understanding the law and desirous of justice would have so held.

§ **3829. Contributions in Actions at Law.** — Except where the governing statute has given a special remedy for a contribution, as in Pennsylvania,[2] the general rule is that it can only be had through the aid of a court of equity. This follows from the discussion which has preceded in another chapter, where it is shown that the very reason of requiring creditors to go into equity is that justice may be done by securing a ratable contribution among the stockholders, which

[1] Sayles *v.* Brown, 40 Fed. Rep. 8. [2] *Ante*, § 3818.

cannot be had in actions at law.[1] It is obvious that if stockholders could sue each other at law for contribution, they might sue each other back and forth to the end of a very long chapter. On the ground that contribution among stockholders can only be had in equity, it has been held that they cannot, by confessing and paying judgments in favor of each other, evade their liabilities to other creditors.[2] There is, however, one doubtful holding to the effect that where the assignee of a demand against a corporation brings an action at law against a single stockholder to enforce his individual liability, and it is shown that the assignor of the demand has an interest in the corporation equal to that of the defendant, a recovery can be had for only half of his demand.[3] By reference to a former chapter[4] it will be discovered that the prevailing judicial theory is that, in such a case, the holder of a demand against a corporation must either proceed in equity, or else *first pay up* all that he stands liable to pay, so as to discharge himself from any liability as a stockholder, before he can proceed at law in the single character of a creditor. It seems to be a sound conclusion, by analogy to the well-known rule in favor of sureties, that where stockholders pay the debts of the corporation, they are entitled to be *subrogated* to any remedies possessed by its creditors against any of its assets which may remain unexhausted. Thus, where the corporation had made an assignment of its assets to an assignee for its creditors, and certain creditors proceeded by a separate creditors' suit against certain stockholders, in disregard of the assignment, the court, in sustaining their right so to proceed, said that if the stockholders paid the amounts for which they respectively stood liable, they would be entitled to be subrogated to all the rights of the complainants to administer the assets in the hands of the assignee.[5] Certain early bank charters in Georgia allowed the stockholder paying off

[1] *Ante*, § 3432.

[2] Meisser *v.* Thompson, 9 Ill. App. 368; *s. c.* affirmed, 108 Ill. 359.

[3] Callanan *v.* Windsor, 78 Iowa, 193; *s. c.* 42 N. W. Rep. 652.

[4] *Ante*, § 3786, *et seq.*

[5] City Bank *v.* Crossland, 65 Ga. 734.

execution against the bank to have the *right to control the fieri facias* against all the other stockholders, so as to collect from each of them his ratable share.[1] There is one holding to the effect that the equitable doctrine of subrogation can be so applied as to work out the right of contribution which one stockholder may have against another who has paid not only his own but that other's proportion of the debts of the corporation.[2] For instance, where a stockholder paid a note of the corporation in order to protect his interest in the corporation, it was held that he was entitled to be subrogated to the rights of the holder of the note, for the purpose of enforcing against another stockholder a contribution of his proportionate share of this debt of the corporation, under a statute making the stockholders of corporations liable for its debts in proportion to their several holdings of shares.[3]

[1] See Lowry *v.* Parsons, 52 Ga. 356.

[2] Redington *v.* Cornwell, 90 Cal. 49; *s. c.* 27 Pac. Rep. 40.

[3] *Ibid.*

CHAPTER LXXII.

PRIORITIES AMONG CREDITORS.

SECTION
3833. Legal priorities preserved in equity.
3834. Judgments satisfied in the order of their date.
3835. Whether a judgment creditor obtains a priority by the filing of his bill.
3836. Distinction as to priorities between creditors' bill and winding-up proceedings.
3837. State entitled to be preferred as a creditor.
3838. Priority of creditor first suing stockholder.

SECTION
3839. Doctrine on this subject in Maine.
3840. Contrary view that the creditor first suing gets no priority.
3841. Whether a stockholder can give a preference to particular creditors.
3842. What if creditor holds property of the corporation delivered in pledge.
3843. Priority of a mortgage of uncalled amounts due upon stock subscriptions.

§ **3833. Legal Priorities Preserved in Equity.**—In determining what legal priorities among creditors a court of equity will preserve, there is considerable difference of opinion. Cases may arise in which this question is immaterial. Thus, in a suit to charge a resident stockholder of a foreign banking corporation, it was held that the defendant could not urge that the *billholders* of a bank were entitled to priority of payment; since provision was made in the law governing the corporation for the payment of the bills by the auditor of the State with the avails of the securities in his hands, and *non constat* that they were not sufficient. If demand had been made on the defendant by the receiver for the amount for which he was made individually liable, for the purpose of paying the holders of the circulation of the bank a deficiency which the stocks in the hands of the auditor did not pay, and he had paid over to the receiver the amount so demanded, it seems that he would be entitled to plead this payment.[1] But

[1] Paine *v.* Stewart, 33 Conn. 516, 530.

the well-known rule in equity in the administration of estates is, that *liens* are not displaced, and that legal priorities are preserved; and this principle has been extended to holding that the unpaid subscriptions of shareholders, when collected by the assignee in bankruptcy of the company, are held by him subject to the lien of *attachments* made before the declaration of bankruptcy.[1]

§ 3834. Judgments Satisfied in the Order of their Date. In a case of this kind the Supreme Court of Georgia has laid down the rule that whenever a judicial preference has been established, that is always preserved in the distribution of assets, even in a court of equity. Whether or not they were all equal as to *equitable* assets there was a conflict of authority, though it seemed that they were; but as to *legal* assets, by which was meant such assets as may be reached by legal remedy or process, in contradistinction to those interests which a judgment creditor must go into equity to subject, it had always been held that execution creditors were entitled to priority and preference. The court, therefore, ordered the whole of the available assets of an insolvent bank to be paid to the *oldest judgment creditors* as fast as they came to hand.[2] Among these assets the court included moneys accruing from the sale of lands in another State; since such moneys were subject to garnishment in the hands of the agent of the corporation.[3] This decision was followed by the same court at a later day, and a charter of a bank making the individual property of each stockholder liable for the redemption of its bills in proportion to the amount of his stock, was construed to entitle the older of two judgments against the bank to be first paid from any money raised by the sheriff out of a stockholder's property.[4]

[1] Re Glen Iron Works, 20 Fed. Rep. 674.

[2] Robinson *v.* Bank of Darien, 18 Ga. 65, 108, 115. Benning, J., dissented, and on a ground which seems of force. The charter of the bank made the persons and property of stockholders "*pledged* and *bound* for the ultimate redemption of the bills and notes issued by and from said bank," etc. This, he thought, meant *all* the bills and notes of the bank.

[3] *Ibid.*, 108, 109.

[4] Lowry *v.* Parsons, 52 Ga. 356.

§ 3835. Whether a Judgment Creditor Obtains a Priority by the Filing of his Bill. — We have incidentally considered this question in the discussion of the subject of *parties*, in relation to the question whether one creditor can proceed in equity alone, or whether he must bring his bill, not only for himself, but in behalf of all other creditors that may choose to join with him;[1] and we have there discovered irreconcilable differences of theory and practice. The same differences of opinion meet us in attempting to deal directly with this subject; and if we go outside the cases relating to the remedies of creditors of corporations against their stockholders, we shall find the same strange and irreconcilable differences of opinion on the question whether the plaintiff in a creditor's bill may proceed for himself alone, or whether he must proceed for all the creditors, and whether he obtains a priority by the filing of his bill. The former Supreme Court of Ohio held that in cases of this kind the creditor, pursuing in the court of chancery the *equitable* assets of his debtor, obtained a preference, except in cases under the statute of assignments.[2] The vigilant creditor, pursuing his claim, acquired a preferable equity, which attached and became a specific lien by the filing of his bill.[3] Accordingly, where such a creditor filed a bill to discover and charge the stockholders, and sequester the tolls of a turnpike company extending through different counties of the State, and under his bill a receiver was appointed, such creditor thereby acquired a priority, and drew within the jurisdiction of the court the whole administration of the fund, which the receiver might control until the complainant, and those permitted to become parties to his suit, had exhausted the assets, or obtained the objects sought by his bill.[4] But the present supreme court of that State has held that where proceedings are instituted by a part of the creditors of an insolvent corporation against the stock-

[1] *Ante*, § 3481, *et seq.*

[2] Miers *v.* Zanesville Co., 13 Ohio, 197; *s. c.* 11 Ohio, 273.

[3] *Ibid.* See Bank of Muskingum *v.* Carpenter's Adm'rs, 7 Ohio, 21, part 1; *s. c.* 28 Am. Dec. 616.

[4] Miers *v.* Zanesville Co., 11 Ohio, 273, 275.

holders, to enforce the liability of the latter for the benefit of all the creditors, no creditor can acquire priority, or institute a separate suit for the enforcement of such liability in his own behalf.[1] A suit to enforce such liability should be brought for the benefit of all creditors.[2] In a case at circuit, which has been much quoted in Georgia, Mr. Justice Bradley took a different view. It was a bill in equity against certain shareholders of a bank, by certain judgment creditors, to subject the amounts due by the former to the bank on account of their stock subscriptions. The charter made the persons and property of the stockholders of the bank at all times pledged and bound for the redemption of any bills and notes issued at any time by the bank, in proportion to the number of shares which each one might possess. It was objected that the bill should have been filed by or on behalf of all creditors, since all were equally interested in the fund sought; but the court overruled this objection, and intimated that there was no law compelling a ratable distribution.[3] In the leading case of Briggs *v.* Penniman,[4] the question arose under an ordinary statute of individual liability. It declared that for all debts due and owing by the company at the time of its dissolution, the persons then composing the company should be responsible to the extent of their respective shares of stock, and no further. Woodworth, J., said that he entertained no doubt that where there were several creditors, the fund made liable for debts, if insufficient to discharge the whole, should be distributed ratably. But if the record failed to disclose that there were other creditors than those who had filed the bill, these were entitled to be fully paid, if the amount of the stock was sufficient.

§ 3836. Distinction as to Priorities between Creditor's Bill and Winding-up Proceedings.—In discussing the question of parties we have already remarked a distinction between a

[1] Wright *v.* McCormack, 17 Ohio St. 86.

[2] Umsted *v.* Buskirk, 17 Ohio St. 113.

[3] Marsh *v.* Burroughs, 1 Woods (U. S.), 463. But see Pollard *v.* Bailey, 20 Wall. (U. S.) 520.

[4] 8 Cow. (N. Y) 387; *s. c.* 18 Am. Dec. 454.

creditor's bill and a *general winding-up bill.*[1] Whilst there is much authority for holding that the diligent creditor who first files his bill to set aside a fraudulent conveyance, or subject property held in trust for his debtor, obtains thereby a preference over other creditors; whilst the law does not favor the conclusion that, after an industrious man has shaken the tree, his lazy neighbor shall be permitted to pick up a portion of the fruit,—yet this principle is believed to be confined to actions at law and to suits in equity in the nature of a creditor's bill. It does not apply to a case where an insolvent corporation is wound up by means of a receiver.[2] Here a court of equity will apply rules of distribution similar to those which obtain in courts of bankruptcy or in the administration of the estates of deceased persons. Creditors of equal dignity share alike, provided they bring their claims to the notice of the receiver before distribution is made; but they may still be paid after distribution, if there are sufficient assets and no claims of higher dignity unpaid.[3] Where a receiver of an insolvent bank, required by the governing statute to proceed as in cases of administration, gave notice to billholders that unless they presented their claims wthin six months their right of priority would cease,—it was held that if the receiver should, after the lapse of this period of six months, distribute the fund without knowledge of the claims of other billholders, who had not presented their bills, he would not be personally liable, nor would the more vigilant billholders, who had received the money in distribution, be held liable to refund, or to contribute to those who did not give notice of their claims within six months.[4]

§ 3837. State Entitled to be Preferred as a Creditor.— There is in our American jurisprudence a shameful principle, inherited from the common law of England and repeated and confirmed by many statutes, that where the State comes into competition with private creditors, the State is entitled to be

[1] *Ante*, § 3481, *et seq.*

[2] Rankine *v.* Elliott, 16 N. Y. 377.

[3] Belcher *v.* Willcox, 40 Ga. 391.

[4] *Ibid.*

preferred. It is a branch of the ancient abomination that the King could do no wrong, that no statute of limitations affected him, and that no *laches* could be imputed to him. The State is *all;* the individual creditor is *one.* There is no conception of justice and common right on which *all* should be preferred to *one,* or on which all should be allowed to take that which belongs to one, leaving him nothing. Yet so it is, under rules of law which remain fundamentally unjust because the judges who have power to change them are careless and ignorant of justice, that in the winding up of an insolvent bank, the poor widow, whose savings of long years may have been swept away in the wreck, gets nothing, while the State, which represents everybody and has the power to recoup its loss through increased taxes levied equally upon the property of all,—gets all there is in the distribution. These observations are suggested by a decision of the Supreme Court of Georgia, where it is held, on general principles of public law, that in the winding up of an insolvent bank *the State* is entitled to a preference over other creditors, although the State is a stockholder.[1]

§ **3838. Priority of Creditor First Suing Stockholder.**—By analogy to the rule which has been declared in the case of a creditor's bill, in those jurisdictions where such a bill is allowed to be brought by one creditor for himself alone, the creditor of a corporation first suing a stockholder in respect of his individual liability, acquires by the bringing of suit a preference over other creditors, which neither they nor the stockholders can defeat,[2] unless possibly by bringing a general winding-up bill.[3] Such a suit may be said to be an *equitable attachment* of the stockholder's liability, to the extent of the plaintiff creditor's claim. It follows that the stockholder cannot, after notice of such a suit, defeat the suing creditor by

[1] Robinson *v.* Bank of Darien, 18 Ga. 65. The official syllabus in this case declares that "it is a wholesome right, and as such, should receive the sanction and approbation of the courts"!

[2] Cole *v.* Butler, 43 Me. 401; Ingalls *v.* Cole, 47 Me. 530, 541.

[3] *Ante*, §§ 3481, 3492.

paying the claims of other creditors so far as to exhaust his liability. If such a power existed, the stockholder could use it as a weapon to defeat creditors altogether.[1] The judgment creditor of an insolvent corporation who *first moves*, under the provisions of a statute of Kansas,[2] to charge a stockholder in respect of his statutory liability, acquires a *priority* of right to recover against such stockholder, with which a creditor subsequently moving cannot interfere.[3] But this is not the rule in all jurisdictions.[4]

§ 3839. Doctrine on This Subject in Maine. — A statute of Maine[5] provided that a judgment creditor of a corporation, after execution returned *nulla bona*, might levy upon the property of any stockholder and collect therefrom an amount equal to the amount of his stock; or he might, at his election, after such judgment, execution, and return of *nulla bona*, have an action on the case against any shareholder. A creditor, after laying the foundation of his suit by judgment against the corporation, execution, and return of *nulla bona*, brought an action on the case against a stockholder who was liable to the extent of $100. Pending this action, other judgment creditors of the corporation sued out executions against the same stockholder, under the other section of the statute, and, being threatened with a levy, he paid them the amount for which he was liable. It was held that this payment was made in his own wrong, and that he could not set it up as a defense to the pending suit. The subsequently moving creditors could not have lawfully levied their executions upon the property of the stockholder, pending the suit previously commenced against him by the plaintiff creditor.[6] But it is not a defense for a stockholder, when he is sued, to show that other creditors had moved against him before the plaintiff, thus laying a foundation for his liability to them; since the claims of such creditors may never be prosecuted to final judgment. Nor is it enough to show that suits have been instituted and are pending on such prior claims, for those suits may not be sustained, or may be abandoned. The liability must be legally established and fixed

[1] Jones *v.* Wiltberger, 42 Ga. 575.

[2] Gen. Stat. Kan. 1889, ch. 23, § 32.

[3] Wells *v.* Robb, 43 Kan. 201; *s. c.* 23 Pac. Rep. 148.

[4] *Post*, § 3840.

[5] Rev. Stat. 1840, ch. 76, §§ 18–20.

[6] Cole *v.* Butler, 43 Me. 401, 403.

to an amount which exhausts it, and this must be *bona fide*, and not colorable or fraudulent.[1]

§ 3840. Contrary View that the Creditor First Suing Gets No Priority. — In Missouri it has been held that the doctrine of the Supreme Judicial Court of Maine, cited in the previous section, is inapplicable to the statute of Missouri. The general rule in this State is that the institution of a suit creates no lien unless some auxiliary process, which the law allows in certain contingencies, is resorted to; and where, upon the bankruptcy of a corporation, a creditor brings an action against a stockholder without first obtaining judgment against the company, there is nothing to take the case out of the rule. Accordingly, where, in a suit brought in 1869, in which judgment had been rendered for the defendant, appealed from, and reversed by the Supreme Court, it was pleaded in the court below that another suit had been commenced against him as a stockholder in 1870, which resulted in a judgment against him for the amount of stock held by him in the corporation, and that he was compelled to pay, and did pay, on such judgment the full amount of his liability as such stockholder, it was held that the plea was a good defense to the action.[2] In Missouri the doctrine has been carried so far that the payment by a stockholder of a *judgment confessed* by him in favor of a *bona fide* creditor of the corporation, is a good defense to an action previously commenced against him by another creditor, if such payment exhausts the amount for which he is liable under the governing statute. Nor was it deemed material in such a case, in the absence of fraud, that the creditor last suing had, with a knowledge of the pending suit derived from the stockholder, purchased the claims sued on at a discount for the purpose of using them as the foundation of his action against the stockholder.[3] In Illinois, however, where several chancery suits had been consolidated and

[1] Ingalls *v.* Cole, 47 Me. 530, 542.

[2] State Savings Asso. *v.* Kellogg, 63 Mo. 540; followed in Bittner *v.* Lee, 25 Mo. App. 559; Manville *v.* Roever, 11 Mo. App. 317. Compare *ante*, § 3608.

[3] Manville *v.* Roever, 11 Mo. App. 317.

held together, and certain of the defendants who had brought suits at law to enforce the individual liability of stockholders, and whose suits had been enjoined in the chancery suits, filed a petition claiming priority as creditors by reason of the institution of their suits at law, in the distribution of the funds collected from the stockholders in the chancery suit, it was held that they were not entitled to such priority, but that the fund, when collected, inured to the benefit of all the creditors who were parties to the suit in chancery. The theory was, that it was not the institution of suit, but the rendition of a final judgment or decree, which created such a lien as will be prescribed in distribution in equity.[1] Another effect of this theory is that in a proceeding by motion against a stockholder under the statute which we are considering, the fact that other creditors of the corporation have subsequently proceeded against the stockholder, is no ground for *postponing* the proceeding.[2]

§ **3841. Whether a Stockholder can Give a Preference to Particular Creditors.** — The answer to this question depends, of course, upon the theory prevailing in the particular jurisdiction. In Missouri, where the institution of the suit by the creditor, although prosecuted with diligence, gives him no right of priority as against another creditor who first recovers a judgment against the particular stockholder, a court has gone to the length of holding that a stockholder may facilitate such a recovery by one creditor by *confessing judgment* in his favor.[3] But the doctrine of the Federal courts being that the superadded statutory liability of the shareholders of a *national bank* is in the nature of a security for the common benefit of its creditors, it has been held that a stockholder of such a bank cannot, by mortgaging his property to secure a particular depositor, create a preference in

[1] Chicago *v.* Hall, 103 Ill. 342 (Walker, J., dissenting).

[2] Marks *v.* Hardy, 12 Mo. App. 595; *s. c.* affirmed, 86 Mo. 232.

[3] Manville *v.* Roever, 11 Mo. App. 317. Although the writer concurred as a judge in this decision in deference to the decisions of the Supreme Court of Missouri, he ventures to think it unsound.

favor of such depositor which will hold, against a proceeding in equity by a receiver of the bank to set it aside.[1]

§ 3842. What if Creditor Holds Property of the Corporation Delivered in Pledge.—Where the relation of the stockholder to the creditors of the corporation is that of *principal debtor*, the fact that the creditor may hold property of the corporation which has been delivered to him in pledge, will not prevent him from proceeding for the satisfaction of his debt against an individual stockholder;[2] for it is well settled that, in the absence of a statute or stipulation to the contrary, the possession of pledged property does not suspend the right of the pledgee to proceed personally against the pledgor for his debt without selling the pledge; since the pledge is merely a collateral security.[3] The pledgee of corporate assets has the right to retain the pledge until the debt is paid. He may retain the pledge and at the same time sue the corporation to recover in respect of the indebtedness; and for the same reason he may retain the pledge and proceed against the stockholder.[4] And, of course, an unexecuted agreement by the corporation to convey property to the creditor does not restrain him from proceeding to enforce the liability of the stockholders.[5] But the creditor may *waive* his right to proceed against the stockholders, by a contract with the corporation;[6] and he may do this by a contract with the corporation whereby the latter agrees to pay *out of its funds only*,—which agreement has the effect of limiting the liability of shareholders.[7] And where he takes a mortgage to secure his debt

[1] Gatch *v.* Fitch, 34 Fed. Rep. 566.

[2] Sonoma Valley Bank *v.* Hill, 59 Cal. 107; *s. c.* 9 Am. Corp. Cas. 20.

[3] *Ante*, § 2656; Sonoma Valley Bank *v.* Hill, *supra;* Bank of Rutland *v.* Woodruff, 34 Vt. 89; Robinson *v.* Hurley, 11 Iowa, 410; *s. c.* 79 Am. Dec. 497; Butterworth *v.* Kennedy, 5 Bosw. (N. Y.) 143; Elder *v.* Rouse, 15 Wend. (N. Y.) 218 (case of a mortgage); Beckworth *v.* Sibley, 11 Pick. (Mass.) 482.

[4] Sonoma Valley Bank *v.* Hill, 59 Cal. 107; *s. c.* 9 Am. Corp. Cas. 200. See further on the right of the pledgee to sue the pledgor while retaining the pledge, Comstock *v.* Smith, 23 Me. 202; Whitwell *v.* Brigham, 19 Pick. (Mass.) 117.

[5] Grew *v.* Breed, 10 Met. (Mass.) 569, 573.

[6] *Ante*, § 3719.

[7] Halket *v.* Merchant Traders' Asso., 13 Ad. & El. (N. S.) 960.

with the distinct understanding that he will look only to the corporation and to the security, he cannot, it has been held, proceed against the stockholders individually.[1]

§ **3843. Priority of a Mortgage of Uncalled Amounts Due upon Stock Subscriptions.** — We have seen that a corporation may *assign* its stock subscription so as to vest in the assignee the power to enforce the same against the subscriber by appropriate action.[2] It equally seems that uncalled amounts, due from its stockholders in respect of their shares, constitute assets of such a character that the corporation may *mortgage* them to a creditor; and where such a mortgage has been made by proper corporate authority, the mortgagees are entitled to have the calls applied in payment of their mortgage debts in priority to the general creditors.[3]

[1] Basshor *v.* Forbes, 36 Md. 154.

[2] *Ante*, § 1818.

[3] Re Pyle Works, 44 Ch. Div. 534.

TITLE SIX.

DIRECTORS.

CHAPTER LXXIII.

RIGHT TO THE OFFICE.

SECTION
3850. Necessity of electing a board.
3851. Effect of failure to elect: tenure of the office: holding until successor chosen.
3852. Mode of compelling election.
3853. Power to fill vacancies.
3854. Power to remove members of the board.
3855. Grounds of removal by judicial action.
3856. *Mandamus* to restore.
3857. Who eligible.
3858. When need not be a stockholder.
3859. Statutes and by-laws requiring such a qualification.
3860. Whether must be a registered stockholder.
3861. Convening the meeting to elect.
3862. Notice of the meeting.
3863. Directors elected after date appointed for election.
3864. Elections at adjourned meetings.
3865. Elections at meetings held outside the State.
3866. Manner of voting.
3867. Frauds and irregularities in the conduct of the election.
3868. Majority of all the shares necessary to elect.
3869. Effect of voting for ineligible candidates.
3870. Right to vote.

SECTION
3871. Voting in respect of shares held by executors or trustees.
3872. Right to vote as between pledgor and pledgee.
3873. Voting in respect of shares held by other corporations.
3874. Statutory limit as to the number of votes which can be cast by a single shareholder.
3875. Disqualifications of the shareholder claiming the right to vote.
3876. Right to vote by proxy.
3877. No superintendence of such elections in equity.
3878. But equity possesses an imperfect jurisdiction.
3879. Jurisdiction by *quo warranto.*
3880. Reviewing such elections under New York statute.
3881. Under California statute.
3882. Persons suing for the office must prove qualification.
3883. Directors suing at law must show title.
3884. Evidence to prove such title: adoption: recognition.
3885. Evidence to prove acceptance of the office.
3886. Resignation or abandonment of the office.
3887. Abandonment or forfeiture by reason of becoming disqualified.

§ **3850. Necessity of Electing a Board.**—All the schemes of corporate organization which are dealt with in this work

contemplate a government through a board of *directors*, or, as they are generally called in eleemosynary corporations, *trustees*. Every statutory scheme of incorporation which the writer has investigated provides for the election of such a governing body. It has even been held that the power to have a board of directors is inherent in all private corporations, and that no special power to that end need be conferred by statute.[1] But while it may be doubted whether an American corporation can possess *any* faculty, even that of electing a governing board, which is not conferred by the act of its creation,—yet where the governing statute *does* authorize or require it, a scheme of organization which dispenses with it until a large proportion of the proposed works are completed may well be regarded as a *fraud* on the dissenting stockholders, since it puts it out of their power to exercise any control over the principal expenditures. Hence, where it was provided, in a scheme of organization of a telegraph company, that no general election of the company should be held until two thousand miles of the line should be equipped, an election of a board of directors and a mode of settling for the work already done were decreed in equity.[2]

§ 3851. Effect of Failure to Elect: Tenure of the Office: Holding until Successor Chosen. — Nearly all the statutes prescribe that the directors elected shall hold their offices for a stated period, and until their successors are chosen;[3] and where it is not so provided by statute, it is common to make by-laws so providing. And if there were no such statute or by-law, it would be the implication of law that the directors should hold over until their successors should be elected and qualified.[4] Not only is this the rule as to ordinary trustees, but it applies equally to the case of a trustee who is elected to *fill a vacancy*.[5]

[1] Hurlbut *v.* Marshall, 62 Wis. 590.

[2] Terwilliger *v.* Great Western Tel. Co., 59 Ill. 249.

[3] For example, see Gen. Stats. Col. 1883, ch. 19, § 6.

[4] People *v.* Runkle, 9 Johns. (N. Y.) 147, 149; Vernon Society *v.* Hills, 6 Cow. (N. Y.) 23; *s. c.* 16 Am. Dec. 429; Foot *v.* Prowse, 1 Strange, 625; Hunter *v.* Sun Mut. Ins. Co., 26 La. An. 13. Compare Reg. *v.* Durham, 10 Mod. 146.

[5] Huguenot Nat. Bank *v.* Studwell, 6 Daly (N. Y.), 13.

Such being the rule, the mere failure so to elect directors does not, *ipso facto*, work a dissolution of the corporation,[1] but an election may be had at any time, in conformity with the governing statute, by-law, or other constating instrument.[2] And so, in New York, a judgment ousting from office so many of the trustees as not to leave a *quorum*, does not constitute an omission or neglect to choose officers, within the meaning of a statute,[3] so as to invalidate the title of the remaining trustees, or to allow the old board to hold over.[4] It is scarcely necessary to say that where the tenure of the office of the directors is fixed by the charter, they cannot enlarge that tenure by establishing a by-law changing the time of holding the election, against the wishes of a majority of the holders of the shares.[5] And this is so even where the governing statute confers all the power of the corporation upon the directors, except the power to increase its capital stock.[6] And if a majority of the board of directors become disqualified for holding their offices, by reason of having transferred their shares, this will not affect the right of the others to remain in office; and therefore the election of an entire new board prior to the expiration of

[1] *Post*, ch. 153.

[2] There is ancient authority for the statement that, though, by the charter of incorporation, the vacancy occasioned by the death or removal of an *alderman* was to be supplied by an election *within eight days* thereafter, yet an election at any time afterwards was good; for the power of election was incident to the corporation, and the affirmative power to elect within eight days did not take away the implied power. Hicks *v.* Borough of Lanceston, 1 Rolle Abr. 514, pl. 6.

[3] N. Y. Laws, 1844, ch. 158, § 3.

[4] People *v.* Fleming, 59 Hun (N. Y.), 518; *s. c.* 37 N. Y. St. Rep. 157; 13 N. Y. Supp. 715. Where there was a by-law providing that the directors should "serve for the term of one year *or* until such time as their successors shall be elected," it was held that the word "or" should be read as "*and*" and that one, having been duly elected, must be considered liable as a director until it should be shown by him that a successor was elected. Chemical Nat. Bank *v.* Colwell, 132 N. Y. 250; *s. c.* 14 Daly (N. Y.), 361; 14 N. Y. St. Rep. 682. Tenure of office of the *first* directors in New York under N. Y. Laws, 1875, ch. 611: Post Express Printing Co. *v.* Coursey, 32 N. Y. St. Rep. 748; *s. c.* 10 N. Y. Supp. 497. Tenure of office of the *first* directors in Pennsylvania: Com. Genth *v.* Helms (Pa.), 26 Week. Not. Cas. 358.

[5] Elkins *v.* Camden &c. R. Co., 36 N. J. Eq. 467.

[6] Nathan *v.* Tompkins, 82 Ala. 437; *s. c.* 2 South. Rep. 747.

the terms of office of those who are not disqualified, will be invalid.[1]

§ **3852. Mode of Compelling Election.** — Such being the necessity of a governing board, if the governing body of the corporation, in disobedience or neglect of a statute or valid by-law, fail or refuse to order an election to choose such a board at the appointed time, a stockholder may have a *mandamus* to compel them to do so, — as where the by-laws of an incorporated hospital required such an election to be held on a certain day in each year;[2] or where the governing statute required the officers of a manufacturing corporation to "cause an election to be held within sixty days," and this without reference to the question whether the by-laws provided for any other than an annual election.[3] Nor was it deemed a defense to an application for a *mandamus* that no *demand* had been made that such an election be held; nor that since the papers were served, the defendants had ordered an election, it appearing that they had attempted, by altering the by-laws, to change the mode of publishing the notice of the annual election, to change the test of the right to vote thereat, and to give persons a right to vote who had not that right previously.[4]

§ **3853. Power to Fill Vacancies.** — As elsewhere more fully shown, the directors of a corporation are merely the managers of its business, and have in general no power to make constituent changes therein.[5] They have therefore no implied power to fill vacancies in their own board.[6] The power of the directors to fill vacancies in their board has been in some cases conferred by statute; but it has been held, con-

[1] Nathan *v.* Tompkins, *supra.* Statutes have been enacted empowering corporations to *decrease the number* of their directors by filing a certificate in the office of the Secretary of State, — such as New Jersey Act 1888, ch. 22, p. 34.

[2] People *v.* Albany Hospital, 61 Barb. (N. Y.) 397.

[3] People *v.* Cummings, 72 N. Y. 433.

[4] People *v.* Albany Hospital, 61 Barb. (N. Y.) 397.

[5] *Ante*, §§ 86, 956, 2076; *post*, § 3979.

[6] Kearney *v.* Andrews, 10 N. J. Eq. 70; Moses *v.* Tompkins, 84 Ala. 613; *s. c.* 21 Am. & Eng. Corp. Cas. 634; 4 South. Rep. 763; 4 Rail. & Corp. L. J. 268.

struing such enabling statutes, that the power can only be exercised by a majority, and that where a *majority* of the existing board resign, the board cannot be filled up by the action of the remaining *minority*.[1] It is obvious, without discussion, that neither the board nor the body of stockholders can fill vacancies which do not exist, and that an election of new directors, where there are no vacancies to be filled, is void; and it has been held that the persons so elected will be restrained at the suit of the stockholders from exercising the office, especially where their interests are antagonistic to the interests of the corporation.[2]

§ **3854. Power to Remove Members of the Board.**—Neither the corporation, in its aggregate capacity, nor its board of directors, can remove a member of the board except in conformity with the provisions of statute, or some valid by-law or other constating instrument.[3] In England a joint-stock company, whose directors are appointed for a definite period, has no inherent power to remove them before the expiration of that period; and if the articles of association contain no power to remove them before the expiration of that period, but authorize the shareholders by special resolution to alter any of the articles, there must be a separate special resolution altering the articles so as to give the power to remove directors, before a valid resolution can be passed removing any of them.[4] So, where there was a by-law providing that "when any director shall die, resign, neglect to serve, or remove out of the county, the board may proceed to supply the vacancy," the board cannot create a vacancy by declaring that the seat of a member has been vacated by reason of his removing out of the county; though if he resigns they may well act on his resignation, and supply the vacancy.[5]

[1] Moses *v.* Tompkins, *supra.*

[2] Nathan *v.* Tompkins, 82 Ala. 437; *s. c.* 2 South. Rep. 747.

[3] Nathan *v.* Tompkins, 82 Ala. 437, 448.

[4] Imperial Hydropathic Hotel Co. *v.* Hampson, 23 Ch. Div. 1.

[5] Com. *v.* Detwiller, 131 Pa. St. 614; *s. c.* 18 Atl. Rep. 990; 7 L. R. A. 357.

§ 3855. Grounds of Removal by Judicial Action.—Directors being *trustees*, in the sense in which the word is commonly used in courts of equity,[1] they are, like other trustees, though not to the same extent, subject to judicial superintendence. They may therefore be removed by such a court at the suit of stockholders who have exhausted their remedy within the corporation, and a *receiver* may be appointed in their stead.[2] But, as we shall more fully see hereafter,[3] this will not be done for mere errors of judgment, or for any thing less than an abuse of trust amounting to misconduct in office.[4]

§ 3856. Mandamus to Restore. — This subject has been considered in a former chapter.[5] The right of restoration of a director or trustee who has been turned out of his office by the other members of the board, seems to rest upon his ability to prove that he was entitled to hold the office *de jure.* And where his election was in fact invalid by reason of a quorum not being present, a *mandamus* to restore him was denied, notwithstanding the fact that his right to hold the office had been recognized by the other members of the board for a considerable length of time, under the mistaken impression that he had been duly elected, — as where he had been elected to the office of secretary, which could only be held by a member of the board.[6]

§ 3857. Who Eligible. — Unless there is a prohibition in the governing statute, or in some valid by-law or other gov-

[1] *Post*, § 4009.

[2] *Post*, § 4121.

[3] *Post*, §§ 4103, 4487, *et seq.*

[4] Ward *v.* Davidson, 89 Mo. 445. Circumstances where the court refused to remove the trustees in charge of the liquidation and appoint a receiver after an assignment for the equal benefit of creditors: Bank of Maryland *v.* Ruff, 7 Gill & J. (Md.) 448. That the stockholders of a corporation who do not vote against the re-election of directors may be deemed to *acquiesce*, by such omission, in acts of such directors done prior to the re-election, and of which stockholders had information sufficient to put them on inquiry; and are not entitled afterwards to have those directors suspended on the ground of *misconduct previous to the re-election*,—see Ramsey *v.* Erie &c. R. Co., 7 Abb. Pr. (N. S.) (N. Y.) 156; *s. c.* 38 How. Pr. (N. Y.) 193.

[5] *Ante*, § 829, *et seq.*

[6] People *v.* New York Infant Asylum, 122 N. Y. 190; *s. c.* 25 N. E. Rep. 241.

erning instrument, it is believed that any person who can be the *business agent* of another, can be the director of a corporation, whether or not he or she is a person who, in the language of the civil law, is called *sui juris*. An *infant* may therefore, it is assumed, be a director, and it has been held that a *married woman* may be a *trustee* of a corporation.[1] While, as hereafter seen,[2] the acceptance of an incompatible office may operate to vacate the office of a director, yet the *treasurer* of a corporation may well be a director.[3] A provision in a bank charter requiring a certain portion of the directors to be *practical mechanics* has been held not to require that they should be in actual practice at the time of election.[4] No reason exists why an *alien* who is a resident of the place of the corporation should be deemed ineligible as a director, unless made so by the charter, governing statute, or other valid governing instrument;[5] and for similar reasons *non-residence* does not seem to render a stockholder ineligible for the office of director, unless it is so declared, — though there are statutes, as in Kansas,[6] declaring that a certain *proportion* of the directors in every corporation must be residents of the State; and such a statute has been held *mandatory*.[7] The inherent power of making *by-laws*, possessed by every corporation,[8] extends so far as to enable a corporation to make a reasonable by-law prescribing the qualifications of its directors; and a by-law has been upheld declaring that no person shall be a director who is *attorney* in a suit against the

[1] People *v.* Webster, 10 Wend. (N. Y.) 554.

[2] *Post*, § 3887.

[3] Sargent *v.* Webster, 13 Met. (Mass.) 497; *s. c.* 46 Am. Dec. 743. But the cashier of a bank could not in *Massachusetts*, because it was so provided by statute. *Ibid.*

[4] Gray *v.* Mechanics' Bank of Alexandria, 2 Cranch C. C. (U. S.) 51.

[5] Com. *v.* Hemingway, 131 Pa. St. 614; *s. c.* 18 Atl. Rep. 992.

[6] Kan. Gen. Stat. 1889, § 1190.

[7] Horton *v.* Wilder, 48 Kan. 222; *s. c.* 29 Pac. Rep. 566. Under a statute permitting a minority of the directors of corporations constructing railroads, canals, or flumes, etc., to *reside out of the State*, a court declined to inquire into the length, extent, or magnitude of the railroad or canal, in order to ascertain whether a non-resident of the State was qualified to be a director. State *v.* Smith, 15 Or. 98; *s. c.* 14 Pac. Rep. 814; 15 Pac. Rep. 137.

[8] *Ante*, § 955.

corporation.[1] It is needless to add that if a director is otherwise qualified, no disqualification attaches to him by reason of the *motives* which may have influenced him in procuring himself to be elected, or what he intends to do in the exercise of his office when he gets into the board.[2]

§ **3858. When need not be a Stockholder.** — As the directors of a business corporation are merely a committee of *managing agents*, incapable of doing any act affecting its *constituent character*,[3] in the absence of a contrary provision in the governing statute, or in a valid by-law or other governing instrument, a person who is not a shareholder can be a director; and this view has been taken by all authoritative courts.[4]

§ **3859. Statutes and By-laws Requiring Such a Qualification.** — Statutes exist, and no doubt generally, requiring directors to be stockholders or proprietors.[5] The construction of these statutes has given rise to a number of difficult questions, — such as whether the registry of the corporation is conclusive as to who is to be considered a stockholder for this purpose, whether one who holds shares in trust for another is so eligible, and the like. Where the question is not definitely settled by the governing statute, it should be carefully settled by a by-law; for even where statutes have prescribed a general rule, their interpretation has been beset with difficulties. It may be stated with confidence at the outset, that in order to be eligible under such a statute or by-law, the holder of shares must be one who holds them *in good faith*, as distinguished from one whose tenure is a mere *sham*.[6] It follows, on grounds

[1] Cross *v.* West Virginia &c. R. Co., 37 W. Va. 342; *s. c.* 18 L. R. A. 582; 16 S. E. Rep. 587.

[2] Railway Company *v.* State, 49 Ohio St. 668; *s. c.* 29 Ohio L. J. 62; 32 N. E. Rep. 933.

[3] *Ante*, §§ 86, 956, 2076; *post*, § 3979.

[4] State *v.* McDaniel, 22 Ohio St. 354; Wright *v.* Springfield &c. R. Co., 117 Mass. 226; *s. c.* 19 Am. Rep. 412 (criticising Penobscot R. Co. *v.* Dummer, 40 Me. 172, 174; *s. c.* 63 Am. Dec. 654; and Spering's Appeal, 71 Pa. St. 121; *s. c.* 10 Am. Rep. 684, 689; Thomp. Off. Corp. 233).

[5] See, for instance, Ark. Dig. Stat. 1884, § 964.

[6] Accordingly, where the charter of a corporation provided that stockholders only should be elected directors, it was held that persons having no interest in the stock, but fraudu-

which are strictly logical, that one who serves as director, where such a statute or by-law is in force, is *liable as a shareholder* to creditors of the corporation, in the event of its insolvency, to the extent, at least, of the qualifying shares which he professes to hold; for he will not be allowed to play fast and loose, and to hold the shares for the purpose of being a director, and not to hold them for the purpose of escaping liability as a stockholder.[1] And it has even been held that he is conclusively to be presumed to be a shareholder in respect of the number of shares necessary to qualify him as a director, whether he possesses any shares or not.[2] In line with this is the view that he must be the *beneficial owner*, though great practical difficulty may arise in many cases in determining who is to be deemed such owner. Nevertheless, this principle has lately, after much consideration, been affirmed by the English Court of Appeal, whose decision is, however, weakened by the dissent of one of the lords justices, himself an eminent authority on this branch of the law. That court hold that a provision in the articles of incorporation, that the qualification of a managing director shall be the holding, in his own right, of corporate shares of a stated nominal value, requires that he shall be the *actual beneficial owner*, and not merely that they shall be registered in his name.[3] Upon the question who is the beneficial owner within this principle, there is no difficulty in concluding that the giving to a third person by a stockholder of a mere *option* to purchase his shares, does not divest him of the title so as to render him ineligible to vote thereon at a corporate election.[4] And so, where the shares have been *mortgaged*, the mortgagor may still be deemed not

lently and collusively receiving the transfer of a share to qualify them, were not eligible; and that such a fraud on the charter would prevent those participating in it from receiving any protection under its provisions to escape personal responsibility for their official acts. Barthollomew *v.* Bentley, 1 Ohio St. 37.

[1] Stock's case, 33 L. J. Ch. (N. S.) 731.

[2] *Ante*, § 1879.

[3] Bainbridge *v.* Smith, 33 Am. & Eng. Corp. Cas. 172; *s. c.* 41 Ch. Div. 462 (Lindley, L. J., dissented).

[4] Re Newcomb, 42 N. Y. St. Rep. 442; *s. c.* 18 N. Y. Supp. 16.

to have lost his qualification to serve as a director.[1] A *by-law* providing that any person chosen as a director shall cease to be such when he ceases to be a proprietor, renders, by reasonable implication, any one who is not a proprietor *ineligible* to the office of director.[2] Where the statute requires that the members of the board must be holders of at least a given number of shares, a director who assigns all his shares to another, *ipso facto*, divests himself of his title to the office;[3] though a different rule has been declared in case of a director *removing* out of the county.[4] A statutory provision,[5] prescribing that a director must be a holder of a given number of shares, is not dispensed with by the mere fact that the corporation has ceased to be a going concern, its franchises being extended merely for the purpose of liquidation.[6]

§ **3860. Whether must be a Registered Stockholder.**— We have already seen that the primary object of registering transfers of corporate shares is to enable the governing body of the corporation to know *who are its members*,—who are entitled to *vote* at its elections and to receive *dividends* declared upon its capital stock;[7] and we have already had occasion to note a

[1] Cumming *v.* Prescott, 2 Younge & C. Ex. 488.

[2] Despatch Line of Packets *v.* Bellamy Man. Co., 12 N. H. 205; *s. c.* 37 Am. Dec. 203.

[3] Chemical Nat. Bank *v.* Colwell, 132 N. Y. 250; *s. c.* 30 N. E. Rep. 644; reversing *s. c.* 9 N. Y. Supp. 285. Compare Beardsley *v.* Johnson, 121 N. Y. 224; *s. c.* 30 N. Y. St. Rep. 691. That unless the person elected possesses this statutory qualification he does not become even a director *de facto*, see Re Newcomb, 18 N. Y. Supp. 16.

[4] Com. *v.* Detwiller, 131 Pa. St. 614; and compare Nathan *v.* Tompkins, 82 Ala. 437.

[5] Rev. Stat. U. S., § 5146.

[6] Richards *v.* Attleborough Nat. Bank, 148 Mass. 187; *s. c.* 19 N. E. Rep. 353; 1 L. R. A. 781. The power of the directors of a railroad company to issue *preferred stock* to *contractors* for the purpose of completing the road, and to make the holding of a certain number of shares of such stock a necessary qualification of a majority of the directors, was upheld under circumstances of *acquiescence* and *estoppel* on the part of the stockholders: Haslehurst *v.* Savannah &c. R. Co., 43 Ga. 13. Statute of Connecticut providing that any one of the directors, etc., of a corporation owning stock in another corporation may be a director in the latter, not repealed: Chase *v.* Tuttle, 55 Conn. 455; *s. c.* 3 Am. St. Rep. 64; 12 Atl. Rep. 874.

[7] *Ante*, § 2387, *et seq.*

general rule that, upon the question who is to be deemed a stockholder for the purpose of answering to the creditors of the corporation, he is to be deemed such whose name stood on the register at the time when the liability attached.[1] By analogy to this principle, the sound conclusion would be that he is to be deemed eligible as a director who holds, according to the register of the corporation, the requisite number of shares, unless the register distinctly shows that he not only does not hold them in his own right, but that he holds them as a naked or dry trustee for another.[2] And where the governing statute, like the English Companies Act, 1862,[3] provides that no notice of any trust shall be entered upon the register, the conclusion would seem to be very cogent that he is to be deemed a shareholder in his own right, for the purpose of being eligible as a director, who holds the requisite number of shares according to the register of the company. Such was the view of that eminent equity judge, Sir George Jessel, M. R.,[4] overruled on doubtful grounds by the Court of Appeal, with one dissenting judge, as stated in the preceding section.[5] So, an American court has held that, although the by-laws of a corporation provide that transfers of stock shall be made only on the corporate books, and that the transfer book shall be closed for ten days previous to the day of the annual meeting of the stockholders, a *bona fide* owner of shares of stock is eligible as a director, although the transfer of his shares to him has not been registered, and although he might, for that reason, be refused permission to vote or to receive dividends.[6]

§ 3861. Convening the Meeting to Elect.—In this matter the governing statute or by-laws must be attended to, with the aid of certain controlling principles which have been already

[1] *Ante*, § 3193.

[2] Re Argus Printing Co., 1 N. D. 434; *s. c.* 26 Am. St. Rep. 639; 9 Rail. & Corp. L. J. 347.

[3] 25 & 26 Vict., ch. 89, § 30.

[4] Pulbrook *v.* Richmond Consolidated Mining Co., 9 Ch. Div. 610.

[5] Bainbridge *v.* Smith, 41 Ch. Div. 462; *s. c.* 60 L. T. (N. S.) 879; 33 Am. & Eng. Corp. Cas. 172 (Lindley, L. J., dissenting).

[6] State *v.* Smith, 15 Or. 98; *s. c.* 14 Pac. Rep. 814; 15 Pac. Rep. 137.

considered. One of these is that where the by-laws of a corporation provide that meetings of the stockholders shall be called by the trustees, the action of the board of trustees is necessary to convene a legal meeting: the *president* of the corporation has no authority to call it.[1] But it has been held not necessary that a *demand* for an annual election of trustees of a corporation should be made upon the board of trustees when in session; a demand upon each individual trustee of the corporation was deemed sufficient.[2] In respect of the officers who may call such a meeting, the principle which validates the action of *de facto* officers of corporations[3] has been held to apply; so that, if those who held under a previous election take measures for holding an election for the succeeding year, their successors, chosen at such election, will be officers *de jure*.[4]

§ **3862. Notice of the Meeting.** — Another of these principles is that, unless the governing statute or by-law fixes the meeting on a day and place certain, a *notice* of its date and place must be given for a reasonable time before it takes place.[5] Where such a notice is required, either by the terms of the governing statute or by the operation of the principle just stated, unless it is explicitly given in respect of *day, hour,* and *place,* the meeting cannot be legally held, unless the stockholders are all present and consenting, whether in person or by proxy.[6] And it has been held that the fact that the *by-laws* fix the *day* upon which such a meeting shall be held is not a sufficient notice of the *time* and *place.*[7] Where a canon of a Protestant Episcopal parish church required that the election of vestrymen should be held on Easter Monday of each year, or as soon thereafter as practicable, and that *notice* thereof should be given during divine service upon the Sunday previous thereto, it was held that a notice given

[1] State *v.* Pettineli, 10 Nev. 141.
[2] State *v.* Wright, 10 Nev. 167.
[3] *Post,* § 3893.
[4] Smith *v.* Erb, 4 Gill (Md.), 437.
[5] *Ante,* § 823.
[6] San Buenaventura Min. &c. Co. *v.* Vassault, 50 Cal. 534; Brown *v.* Electric Min. Mach. Co., 22 Pitts. L. J. (N. S.) 343.
[7] *Ibid.*

several hours before the regular time for divine service was insufficient, and an election thereunder was void.[1] On the other hand, the mere fact that the meeting of the board of directors, at which the stockholders' meeting was summoned, was convened without the proper notice, is not a good ground of challenging the validity of the action of the stockholders' meeting, providing it was otherwise regularly summoned.[2] It should be added that the proceedings of a meeting of stockholders, no matter where held or how irregularly summoned, bind all who participate in them without dissent.[3]

§ 3863. Directors Elected after Date Appointed for Election. — "Provisions in statutes and by-laws requiring the election of directors to be had on a specified day are regarded as *directory*, and the election, if not held on the regular day, may be held at a later day; and the directors then chosen, if there be no other irregularity or informality in their title, will be directors *de jure*."[4] The reason is, that the power of electing officers is, by the common law, *inherent* in every corporation, and that the power is consequently not lost by failing to exercise it within the appointed time.[5]

§ 3864. Elections at Adjourned Meetings. — It has been held that, where no time is fixed by the governing statute for the duration of such an election, it is competent for the

[1] Dahl *v.* Palache, 68 Cal. 248; *s. c.* 9 Pac. Rep. 94. That an annual election on a *movable day*, such as Pinxter Monday, is valid, see People *v.* Runkle, 9 Johns. (N. Y.) 147, 158.

[2] Browne *v.* La Trinidad, 37 Ch. Div. 1; *s. c.* 57 L. J. Ch. 292; 58 L. T. (N. S.) 137.

[3] Handley *v.* Stutz, 139 U. S. 417; Henderson *v.* Bank of Australia, 40 Ch. Div. 170; *s. c.* 8 Rail. & Corp. L. J. 213. What *misdescription* of the corporation in the *notice* will not vitiate: Langan *v.* Francklyn, 20 N. Y. Supp. 404.

[4] Beardsley *v.* Johnson, 121 N. Y. 224, 228; *s. c.* 30 N. Y. St. Rep. 691; affirming *s. c.* 16 N. Y. St. Rep. 773; 1 N. Y. Supp. 608. So held in Hughes *v.* Parker, 20 N. H. 58. So held in Nashua Fire Ins. Co. *v.* Moore, 55 N. H. 48, in regard to a *by-law*. See also Vandenburgh *v.* Broadway &c. Ry. Co., 29 Hun (N. Y.), 348; Vernon Society *v.* Hills, 6 Cow. (N. Y.) 23; *s. c.* 16 Am. Dec. 429; People *v.* Runkle, 9 Johns. (N. Y.) 147.

[5] Hicks *v.* Borough of Lanceston, 1 Rolle Abr. 514, pl. 6.

inspectors, in the exercise of a sound discretion, to adjourn the election from day to day, keeping the polls open.[1] And it has been held that an election of directors at an adjourned meeting is not invalidated by the fact that votes were cast at a previous meeting, where the inspectors, with the acquiescence of the stockholders, after discovering that four of the candidates receiving a majority of the votes were ineligible, adjourned without declaring the result, and held a new election regular in form.[2] It should be carefully kept in mind that what is to be done in such exigencies is in many States the subject of statutory regulation, which statutes must be carefully attended to. Thus, by the statute of Wisconsin, if the meeting for an election of directors in a railway company is not held at the proper time, it may be held thereafter on twenty days' notice.[3] On the other hand, it has been held not competent for a majority of the stockholders, after acquiescing in the organization of the meeting and participating in its business, to withdraw from it, and organize another meeting at the same time and place.[4]

§ 3865. Elections at Meetings Held outside the State. — If the charter, governing statute, articles of association, by-laws, or other governing instrument, requires such an election to be held within the limits of the State under whose laws the corporation is created, then, in the absence of circumstances of estoppel, an election held outside the State will be invalid; and, as against the officers so elected, the existing incumbents of the office will have a better title thereto.[5] But the proceedings at such a meeting will bind all those who participate in them without objection;[6] and it has been held that the fact that a stockholder was present at *previous meetings* held at the same place, without objecting to the meetings

[1] Re Chenango Mutual Ins. Co., 19 Wend. (N. Y.) 635.

[2] Re Newcomb, 42 N. Y. St. Rep. 442; *s. c.* 18 N. Y. Supp. 16.

[3] Rev. Stat. Wis. 1878, § 1822.

[4] Re Argus Printing Co., 1 N. D. 434; *s. c.* 26 Am. St. Rep. 639; 48 N. W. Rep. 347.

[5] Hodgson *v.* Duluth &c. R. Co., 46 Minn. 454; *s. c.* 49 N. W. Rep. 197.

[6] Handley *v.* Stutz, 139 U. S. 417.

being held at that place, would raise an *estoppel* against him. For stronger reasons, a *creditor* having dealt with the corporation upon the assumption of its being a valid body, cannot raise, in a collateral proceeding, the objection that its directors were elected at a meeting held in another State.[1]

§ **3866. Manner of Voting.** — This, in like manner, is generally the subject of regulation, either by constitutional provisions, by statutes, or by by-laws of each particular corporation, and no attempt to codify these regulations can be made in a work of this kind. To protect the rights of minorities, constitutional provisions [2] and statutes [3] have established the principle of cumulative voting already described. These statutes are *not* retroactive, and do not apply to corporations in existence at the time of their passage.[4] And where such constitutional provisions and statutes have not been enacted, the right to vote cumulatively does not exist.[5] But a *majority* of the votes of those present and offering to vote, and entitled to vote, is necessary to elect; and persons receiving a *minority* of the votes cast for directors, cannot, in a *quo warranto* proceeding, be declared elected, although it appear that the judges improperly rejected enough legal votes offered to give a majority.[6]

§ **3867. Frauds and Irregularities in the Conduct of the Election.**—Aside from such safeguards, it is a principle here, as well as in the law of contract, that corporate elections will be set aside by courts which possess, under statutes or otherwise, the power to superintend them, where the successful party has succeeded by means of *fraud*, *trickery*, *surprise*, or other unfair practices.[7] Thus, where the notice fixed the

[1] Wright *v.* Lee, 20 S. D. 596; *s. c.* 51 N. W. Rep. 706.

[2] *Ante*, § 754.

[3] *Ante*, § 755.

[4] Hays *v.* Com., 82 Pa. St. 518.

[5] State *v.* Stockley, 45 Ohio St. 304; *s. c.* 13 N. E. Rep. 279.

[6] State *v.* McDaniel, 22 Ohio St. 354. By statute in *Indiana*, there is to be *one vote for each share:* 2 Rev. Stat. Ind. 1888, § 3021.

[7] People *v.* Albany &c. R. Co., 55 Barb. (N. Y.) 344; *s. c.* 7 Abb. Pr. (N. S.) (N. Y.) 265; 38 How. Pr. (N. Y.) 228.

time of holding the election at twelve o'clock M., and the meeting was called to order about fifteen minutes before twelve, the election was set aside as a surprise and fraud upon the stockholders who did not participate in it, notwithstanding the meeting was reorganized at twelve o'clock,—the court taking the doubtful view that the reorganized meeting was but a continuation of the first one.[1] On the other hand, it has been held that a denial of his right to vote will not justify one who holds a majority of the stock in withdrawing from the meeting and *organizing another meeting* and voting there, since his vote at the original meeting may be rendered effective by judicial aid, notwithstanding its rejection.[2] Again, it may be said that *irregularities* in matters of form will not avoid a corporate election otherwise fairly held,—as where an *adjournment* takes place during the process of balloting;[3] or where the inspectors keep the polls open somewhat longer than the hour named in the notice, in the exercise of a reasonable discretion, and for the purpose of enabling stockholders present and offering to vote, to do so.[4] But irregularities in matters of *substance* may be so gross as to justify a court in declaring that there has been no election at all,—as where, at a meeting of all the stockholders, only a portion of them participated in the election of trustees; where the president, although present, did not preside; where no president *pro tempore* was chosen; and where no person who participated in the proceedings was authorized to receive the ballots or declare the result.[5] An *agreement among* some of the *shareholders*, who, together, own a majority of the stock, that all will vote for certain directors believing that they will, if elected, manage the affairs in a certain way; or to hold their shares and sell only together,—is not necessarily unlawful or contrary to pub-

[1] People *v.* Albany &c. R. Co., 55 Barb. (N. Y.) 344; *s. c.* 7 Abb. Pr. (N. S.) (N. Y.) 265; 38 How. Pr. (N. Y.) 228.

[2] Re Argus Printing Co., 1 N. D. 434; *s. c.* 26 Am. St. Rep. 639; 12 L. R. A. 781; 9 Rail. & Corp. L. J. 347.

[3] Penobscot &c. R. Co. *v.* Dunn, 39 Me. 587.

[4] People *v.* Albany &c. R. Co., 55 Barb. (N. Y.) 344; *s. c.* 7 Abb. Pr. (N. S.) (N. Y.) 265; 38 How. Pr. (N. Y.) 228.

[5] State *v.* Pettineli, 10 Nev. 141.

lic policy.[1] The extent to which *irregularities of form* in the election of directors have been overlooked in England may be illustrated by a case where it was decided that where all the subscribers to a memorandum of association concurred in the appointment of the first directors, the fact that they *did not meet together* for the purpose of coming to their determination did not invalidate their act; and also that a *resolution* passed at a general meeting at which an election to fill vacancies might have been held, authorizing the existing directors to continue in their offices, was tantamount to a re-election of them.[2]

§ 3868. Majority of All the Shares Necessary to Elect.— Recurring to what has been said on this subject in a former chapter,[3] the *general rule* cannot be doubted that a joint-stock corporation is a body composed of a *definite number*, within the rule that a majority of that number is required to elect; and further that the number here intended is the *number of shares*, and not the number of members.[4] Statutes no doubt exist confirming this rule,[5] and some of these, providing for *cumulative voting*, have already been considered.[6]

§ 3869. Effect of Voting for Ineligible Candidates.—The doctrine already considered, that votes for ineligible candidates are "*thrown away*,"[7] is illustrated by a recent decision in Kansas, under a statute providing that every corporation, created or existing under the laws of that State, shall have at least *three* of its directors citizens and *residents* of the State.[8] Where, with the statute in force, at a corporate election two opposing factions, voting cumulatively, had succeeded in electing eleven non-resident directors, thus filling the num-

[1] Havemeyer *v.* Havemeyer, 43 N. Y. Super. Ct. 506.

[2] Re Great Northern Salt &c. Works, 44 Ch. Div. 472.

[3] *Ante*, § 726, *et seq.*

[4] Ellsworth Woolen Man. Co. *v.* Faunce, 79 Me. 440; *s. c.* 10 Atl. Rep. 250; Re Argus Printing Co., 1 N. D. 434; *s. c.* 26 Am. St. Rep. 639; 9 Rail. & Corp. L. J. 347.

[5] *Ante*, § 727.

[6] *Ante*, § 755.

[7] *Ante*, § 752.

[8] Gen. Stat. Kan. 1889, § 1190.

ber of the board, but the chairman of the meeting declared that, as the law required three directors to be citizens and residents, three residents and citizens, who had received a few scattering votes, were elected, and that the eight non-residents, who had received the highest number of votes, were elected to complete the board,—and the three non-residents, who had been in fact elected, but who were thus excluded by the ruling of the chairman, brought a proceeding in the nature of *quo warranto* to be installed,—it was held that they could not maintain the proceeding because ineligible.[1]

§ **3870. Right to Vote.** — The right of voting stock at corporate elections is a part of the stockholder's property, incident to his ownership of the stock, and inherent in him by virtue thereof.[2] But this right to vote is necessarily predicated upon the *bona fide* ownership of shares; and under a statute affirming this principle,[3] a *dummy*, to whom a block of shares had been issued by the secretary of a corporation to be voted at an election, was not entitled to vote in respect of them, since he was neither a *bona fide* shareholder, nor the representative of one.[4] But where the ownership of the shares is *bona fide*, then, as a general rule, the *motive* of the shareholder in voting cannot be inquired into. And it has been held that an agreement among several shareholders that they will hold their shares in trust and vote it as a unit in all matters pertaining to the government of the corporation, as determined by a majority of their number, is not *per se* illegal; though a further stipulation that although the signers of the agreement may sell their shares, yet they cannot sell the right to vote in respect of them, but that the transferee will only retain the transferor's right, namely, the right to own, but not the right to vote, is in restraint of the alienation

[1] Horton *v.* Wilder, 48 Kan. 222; 29 Pac. Rep. 566.

[2] Com. *v.* Dalzell, 152 Pa. St. 217; *s. c.* 34 Am. St. Rep. 640; 25 Atl. Rep. 535; reversing *s. c.* 23 Pitts. L. J. (N. S.) 69; 1 Pa. Dist. Rep. 657.

[3] Cal. Code Civ. Proc., § 312.

[4] Stewart *v.* Mahoney M. Co., 54 Cal. 149.

of property, and is void under the principles of the common law.[1]

§ 3871. Voting in Respect of Shares Held by Executors or Trustees.—The general rule being that the right to vote follows the legal title to the shares, it must follow that, where the title to the shares is vested in two or more persons jointly, there can be no vote cast in respect of them without the *concurrence of all the joint owners.* When, therefore, the legal title was vested, under a will, in three executors, it was held that, unless all of them could agree as to the manner in which the shares should be voted, they could not be voted at all; nor was this conclusion affected by the fact that a codicil of the will provided that the shares should be voted as one of the executors should direct, and that the other executors should give him a proxy, where no proxy in fact had been given, and no legal proceedings had been taken to compel the giving of one.[2] A contractual arrangement for the creation of a "*voting trust*" to control several corporations for the purpose of drawing them into a combination, being illegal under principles hereafter considered,[3] any shareholder can withdraw from such an arrangement; and this, it seems, without destroying the valid provisions of such a contract, if any there be.[4]

§ 3872. Right to Vote as between Pledgor and Pledgee. The general rule is, that the *right to vote follows the legal title* to the shares, and is an incident of that title; and this rule is believed to obtain in all cases where it has not been changed by a valid statute, by-law, or contract.[5] Statutes have been

[1] Moses *v.* Scott, 84 Ala. 608; *s. c.* 4 South. Rep. 742.

[2] Tunis *v.* Hestonville &c. R. Co., 149 Pa. St. 70; *s. c.* 15 L. R. A. 665; 24 Atl. Rep. 88 (affirming 1 Pa. Dist. Rep. 135). That the provision of the codicil that the other executors should give such a proxy deprives them of any discretion as to the manner in which the stock shall be voted, and leaves them no ground for refusing the proxy, see Re Lafferty's Estate, 2 Pa. Dist. Rep. 215,

[3] *Post,* § 6401.

[4] State *v.* Ohio &c. R. Co., 6 Ohio C. C. 414.

[5] *Ante,* §§730, 732; Com. *v.* Dalzell, 152 Pa. St. 209, 217; *s. c.* 34 Am. St.

enacted affirming this principle.[1] Shares may be transferred for the purpose of securing a debt, but under a form of contract which operates to pass the legal title to the transferee and to give him the right to have the shares registered in his name on the books of the corporation,—in which case the right to vote them will vest in him.[2] In considering this subject, the distinction must not be overlooked between the case where the question arises as between the person claiming the right to vote and the corporation, and where it arises as between him and another person claiming the right to vote. In the former case, the general rule seems to be that the corporation is entitled to stand upon its register; but in the latter case the real ownership of the shares may be inquired into by the courts, though not, it seems, by the inspectors of the election;[3] though even this rule has been in some cases changed by statute.[4]

§ 3873. Voting in Respect of Shares Held by Other Corporations.—The power of one corporation to be a shareholder in another has been already considered.[5] Where the power is conceded, either by the statute law in express terms or by judicial construction, it would seem to follow that the right to vote in respect of the shares would exist as a mere incident of their ownership.[6] But, in the absence of legislative authority or

Rep. 640; 25 Atl. Rep. 535 (reversing *s. c.* 23 Pitts. L. J. (N. S.) 67; 1 Pa. Dist. Rep. 667).

[1] *Ante*, § 733; Miller *v.* Murray, 17 Col. 408; *s. c.* 30 Pac. Rep. 46.

[2] State *v.* Smith, 15 Or. 98; *s. c.* 14 Pac. Rep. 814.

[3] *Ibid.; ante*, § 732. That the sale of an *option to purchase shares* within two years does not divest the right to vote of the vendor, under N. Y. Laws 1880, ch. 510, § 2, see Re Newcomb, 18 N. Y. Supp. 16. That the enumeration in Pa. Act, May 7, 1889 (P. L. 102), of certain classes of trustees as entitled to vote upon the stock held by them, does not include other trustees not enumerated,—such as pledgees whose pledgors have not reserved the right to vote,—see Com. *v.* Dalzell, 152 Pa. St. 217; *s. c.* 34 Am. St. Rep. 640; 25 Atl. Rep. 535; reversing 23 Pitts. L. J. (N. S.) 69; 1 Pa. Dist. Rep. 657.

[4] See, for instance, Com. *v.* Dalzell, 152 Pa. St. 217; *s. c.* 34 Am. St. Rep. 640, construing a statute of Pennsylvania.

[5] *Ante*, § 2054, *et seq.*

[6] So held in Davis *v.* United States Electric &c. Co., 77 Md. 35; *s. c.* 25 Atl. Rep. 982. So also held in respect of a religious corporation holding shares in a building association,

sanction for such a course of proceeding, it is against public policy to allow one corporation to purchase a majority of the shares in another for the purpose of absorbing it, controlling it, and effecting an unlawful consolidation with it; and a court of equity, having jurisdiction in the premises, will restrain the purchasing corporation from voting at an election in respect of such shares.[1]

§ 3874. Statutory Limit as to the Number of Votes Which can be Cast by a Single Shareholder.—For the purpose of protecting the rights of minority shareholders, the statute law has in some cases imposed limits upon the number of votes which can be cast by a single shareholder. An Alabama charter, for instance, contained the provision that "no stockholder, either in his own right, or as proxy or agent of others, shall be entitled to cast more than one-fourth of all the votes at any election of directors." Assuming, of course, the validity of this provision, it was declared that it was intended for the benefit and protection of minority stockholders, and that it deserved to be upheld with a strong hand, and could not be defeated or evaded by a stockholder making nominal transfers of his shares to other persons and having them voted by them in his interest.[2] A regulation of an agricultural and mechanical association, providing that stockholders should have one vote for each share held by them up to ten shares, and fixing the proportion which their votes should bear to their shares above that number, has been held reasonable, when uniform in its operation, and binding on all the stockholders.[3]

and voting them by proxy duly authorized by the board of trustees of such religious corporation, in State *v.* Rohlffs, (N. J. L.) 19 Atl. Rep. 1099.

[1] The text is supported by two striking decisions, both illustrating the evils of permitting large corporations thus to swallow up and wreck smaller ones, and both worthy of the highest commendation: Memphis &c. R. Co. *v.* Woods, 38 Ala. 630; *s. c.* 16 Am. St. Rep. 81; 7 South. Rep. 108; 7 L. R. A. 605; Clark *v.* Central &c. Co., 50 Fed. Rep. 338; *s. c.* 15 L. R. A. 683.

[2] Mack *v.* De Bardeleben Coal &c. Co., 90 Ala. 396; *s. c.* 9 L. R. A. 650; 8 Rail. & Corp. L. J. 394; 8 South. Rep. 150; 31 Am. & Eng. Corp. Cas. 389.

[3] Com. *v.* Detwiller, 131 Pa. St. 614; *s. c.* 18 Atl. Rep. 990.

§ **3875. Disqualifications of the Shareholder Claiming the Right to Vote.**—As a general rule, the *motive* governing the shareholder in casting his vote cannot be made the subject of a judicial inquiry; and the fact that a stockholder may have a personal interest separate from the others, which he is endeavoring to subserve, does not deprive him of his right to vote.[1] Limitations of this principle exist in cases where one corporation purchases the shares of another for the purpose of absorbing and wrecking the latter.[2] Under a section of the National Currency Act,[3] a shareholder who is in default to the corporation in respect of his share subscription is not entitled to vote at a corporate election,[4] and the disability, being in the nature of a *penalty*, has been restricted to that species of default, and has been held not to extend to a default in respect of any other indebtedness due the corporation.[5]

§ **3876. Right to Vote by Proxy.**—In addition to what has already been said upon this subject,[6] we may note decisions to the effect that a stockholder, and *a fortiori* a director, cannot vote by proxy, in the absence of a provision in the charter or by-laws justifying that course;[7] that if, on grounds of public policy, the shareholder granting the proxy would be enjoined from voting, his proxy will be so enjoined;[8] that while, as a general rule, the *grounds* upon which a shareholder

[1] Bjorngaard *v.* Goodhue County Bank, 49 Minn. 483; *s. c.* 52 N. W. Rep. 48.

[2] See, for instance, Memphis &c. R. Co. *v.* Woods, 88 Ala. 630; *s. c.* 16 Am. St. Rep. 81; *ante*, § 3873. It has been held that power given to one of three *executors* to control the voting of corporate stock belonging to the estate cannot be abridged because he has used such power for his own interest, where his conduct is not such as will warrant his dismissal from the trust. Re Lafferty's Estate, 2 Pa. Dist. Rep. 215.

[3] Rev. Stat. U. S., § 5144. The language is, that "no shareholder whose *liability* is past due and unpaid shall be allowed to vote."

[4] United States *v.* Barry, 36 Fed. Rep. 246.

[5] *Ibid.*

[6] *Ante*, § 736, *et seq.*

[7] Perry *v.* Tuscaloosa Cotton-Seed Oil-Mill Co., 93 Ala. 364, 371; *s. c.* 9 South. Rep. 217.

[8] Clarke *v.* Central R. &c. Co., 50 Fed. Rep. 338; *s. c.* 15 L. R. A. 683.

proposes to exercise his right of voting cannot be made the subject of judicial inquiry,[1] yet where a proxy has been granted, irrevocable for five years, to vote at all stockholders' meetings upon the shares of certain members, in consideration of an agreement to continue one of them as manager at a stated salary, those who have given the proxy will be entitled to relief by injunction against voting in respect of it, notwithstanding their position *in pari delicto*.[2]

§ 3877. No Superintendence of Such Elections in Equity. The prevailing view is, that courts of equity have no jurisdiction to superintend corporate elections by turning out an usurping board and installing the rightful incumbents,— though, on principle, having regard to the ample jurisdiction of such courts over matters of *fraud*, *fraudulent conspiracy*, and *trust*, it is not perceived why their jurisdiction does not contain within its principles the amplest means of relief in such cases. The general ground on which the jurisdiction of equity is denied is, that *courts of law* exercise an ample and effective jurisdiction over the subject by *quo warranto*, and that the party complaining has an adequate remedy at law.[3] Under ordinary circumstances such a right cannot be tried in a court

[1] *Ante*, § 3870.

[2] Cone *v.* Russell, 48 N. J. Eq. 208; *s. c.* 9 Rail. & Corp. L. J. 513; 21 Atl. Rep. 847. English decisions on this subject have little value in this country, since they turn upon provisions in articles of association under which the voting is by a *show of hands*, unless a *poll* is demanded (Reg. *v.* Government Stock Invest. Co., 3 Q. B. Div. 442); in which latter case the vote is sometimes to be counted according to the number of persons holding proxies, and not according to the number of shares held. Re Bidwell [1893], 1 Ch. 603. Compare Re Caloric Engine &c. Co., 52 L. T. (N. S.) 846; Re Horbury &c. Co., 11 Ch. Div. 109. Election set aside because date of election left blank in *proxy*. Re Townshend, 18 N. Y. Supp. 905. What agreement vesting voting power in committee to settle differences, etc., not against public policy: State *v.* Ohio & M. R. Co., 6 Ohio C. C. 414. Invalidity of a revocable *proxy* under N. Y. Laws 1892, ch. 564, against stockholders *selling their votes:* Re Germicide Co.'s Directors' Election, 48 N. Y. St. Rep. 294; 20 N. Y. Supp. 495.

[3] Owen *v.* Whitaker, 20 N. J. Eq. 122. That there is a remedy by *quo warranto*, see People *v.* Peck, 11 Wend. 604; *s. c.* 27 Am. Dec. 104; *ante*, § 766; Mozley *v.* Alston, 1 Phil. Ch. 790, 801, *per* Ld. Lyndhurst.

of equity; though, we shall hereafter see,[1] there may be cases where a court of equity would interfere, but only upon the ground that, for some reason, the legal remedy had become plainly inadequate, — as where it would be necessary to compel a *discovery* by the defendant of certain records.[2] Thus, Lord Lyndhurst held that the Court of Chancery would not entertain a bill by shareholders of an incorporated company which sought merely to restrain the directors *de facto* from acting as such, on the sole ground of an alleged invalidity of their title to their offices, no authority having been produced for such a course, and the whole question being a question of law.[3] In like manner, it was held by Sir William Grant, M. R., that the Court of Chancery "has no jurisdiction with regard either to the *election* or the *amotion* of corporators of any description." "Eleemosynary corporations," said he, "are the subject of visitorial jurisdiction; and where, for want of an heir of the founder, the crown becomes the visitor, it is by petition to the Great Seal, and not by bill of information, that the removal of a governor from the corporate character, which he *de facto* holds, is to be sought."[4] Thus, in a case where the election of the governors of a *charity* was had under such circumstances that it was proper that they should be removed, Lord Eldon declined to proceed to their removal until a petition was presented to him in his visitorial capacity. He disclaimed authority to do it in a proceeding by information by the Attorney-General.[5] For the same reason Chancellor Kent refused to grant a preliminary injunction restraining certain persons, alleged to be acting as directors by virtue of an election colorable in point of law, though fraudulent in point of fact, where the bill did not show any danger of irreparable loss to the corporation. However, he seems not to have doubted the jurisdiction of a court of equity to entertain the inquiry whether the directors were lawfully exercising

[1] Next section.

[2] Hartt *v.* Harvey, 32 Barb. 55; *s. c.* 10 Abb. Pr. (N. S.) (N. Y.) 321.

[3] Mozley *v.* Alston, 1 Phil. Ch. 790, 801.

[4] Attorney-General *v.* Clarendon, 17 Ves. 491, 498.

[5] Attorney-General *v.* Dixie, 13 Ves. 519.

their functions.[1] In New York, where the Legislature has provided a summary remedy by an application to the Supreme Court to set aside an election of corporate directors if it be illegal,[2] the latter doctrine was that a court of chancery would not take jurisdiction for that purpose; nor would such a court interfere to restrain by injunction the newly elected trustees of a corporation on the ground that they are usurping the powers of trustees, unless there be an allegation that they are insolvent and are irresponsible.[3] So, in Pennsylvania, an injunction will not be continued against a corporation merely because a dispute has arisen as to the election of directors who have not yet even taken their seats.[4]

§ **3878. But Equity Possesses an Imperfect Jurisdiction.** — But equity possesses an imperfect and qualified jurisdiction in such cases, which modern holdings show a distinct tendency to enlarge. Thus, as suggested in the previous section, in the case of *incorporated charities*, equity exercises a control by derivation from the *visitorial power* of the crown, which control is often ascribed to the general jurisdiction which equity has over the subject of *trusts*. In the exercise of this jurisdiction, in a controversy between two sets of persons claiming to be trustees of a *religious* corporation, the court of chancery in New York had authority to appoint one set as trustees, and vest them with the trust property, and their acts, while such trustees, in relation to third parties, could be sustained on the ground that they were trustees *de facto*.[5] In the case of schisms in *religious bodies*, courts of equity, in virtue of their jurisdiction over trusts, constantly exercise

[1] Ogden *v.* Kip, 6 Johns. Ch. (N.Y.) 160.

[2] 1 R. S. N. Y. 603, § 5.

[3] Mickles *v.* Rochester City Bank, 11 Paige (N. Y.), 118; *s. c.* 42 Am. Dec. 103. See further, as to the jurisdiction in New York, Mickles *v.* Rochester City Bank, 11 Paige (N.Y.), 118; *s. c.* 42 Am. Dec. 103; Hartt *v.* Harvey, 32 Barb. (N. Y.) 55, 64; *s. c.* 10 Abb. Pr. (N. Y.) 330; *s. c.* 19 How. Pr. (N. Y.) 245, 255; North Baptist Church *v.* Parker, 36 Barb. (N. Y.) 176; People *v.* Albany &c. R. Co., 57 N. Y. 161, 172.

[4] Paynter *v.* Clegg, 9 Phil. (Pa.) 480.

[5] Lovett *v.* German Reformed Church, 12 Barb. (N. Y.) 67.

the power of vesting the temporalities in that party which adheres to the purposes of the original trust, — that is, to the faith, doctrine, and discipline of the original organization. And in the case of a *joint-stock corporation* in New York, relaxing earlier conceptions, it has been held that, although an injunction by which inspectors of election in a corporation are commanded to desist and refrain from holding any election of directors, or from receiving and counting and canvassing any votes, is improvident, — yet an injunction requiring such inspectors, their successors, etc., to desist from holding any election, while the plaintiffs and other owners of certain stock shall be forbidden to vote upon the same, is valid; and it is the duty of the inspectors to obey it.[1] Again, in New Jersey, departing somewhat from an earlier holding,[2] the power of a court of equity to review an election of directors which has been *fraudulently conducted*, has been asserted; and in the particular case such an election was reviewed and adjudged fraudulent and void, on the ground of insufficiency of notice, and falsity of the list exhibited and acted upon as the list of stockholders entitled to vote.[3] And it has somewhat recently been laid down in Alabama that where the question of the legality of a corporate board of directors *arises incidentally* in a suit to enjoin their unauthorized acts, a court of equity will not refuse to pass on it, — as where a bill is brought to enjoin an unlawful consolidation.[4] Under

[1] People *v.* Albany &c. R. Co., 55 Barb. (N. Y.) 344; *s. c.* 7 Abb. Pr. (N. S.) (N. Y.) 265; 38 How. Pr. (N. Y.) 228.

[2] Owen *v.* Whitaker, 20 N. J. Eq. 122.

[3] Johnston *v.* Jones, 23 N. J. Eq. 216.

[4] Nathan *v.* Tompkins, 82 Ala. 437; *s. c.* 19 Am. & Eng. Corp. Cas. 336; 2 South. Rep. 747; 2 Rail. & Corp. L. J. 315. In this case it was held that, under the Alabama Code, §§ 1917, 1928, the directors of a street railway company must be elected annually, and hold office until the qualification of their successors. A majority cannot change the term of office by changing merely the time for an annual meeting of stockholders. If a transfer of the stock of a majority of the directors constitutes good cause for their removal from office, it does not constitute cause for the election of a new board; and equity will interfere by injunction to restrain such new board from interference with the corporate management. *Ibid.*

the statute of Pennsylvania conferring chancery jurisdiction upon the supreme court and courts of common pleas,[1] it is held that those courts have the jurisdiction and powers of a court of chancery so far as relates to the supervision and control of all corporations, other than those of a municipal character; that this confers upon such courts all the powers and jurisdiction of a court of chancery over such corporations, to be exercised in the ordinary mode in which a court of chancery acts; that this power includes the power of supervising and controlling the election of directors, whenever it is made to appear that, by means of fraud, violence, or other unlawful conduct on the part of a portion of the corporators, a fair and honest election cannot be held; and that, under the equity rules, such a court may *appoint a master to preside over and supervise such election.*[2]

§ **3879. Jurisdiction by quo Warranto.** — The ancient jurisdiction at law, exercised by the writ of *quo warranto*, or in modern times by an information in the nature of the writ of *quo warranto*, rests upon the right of the sovereign, that is to say, the State, to know by what authority the body of men, professing to exercise certain powers not possessed by all citizens as of common right, do exercise those powers. While this remedy is more commonly used to try the right of the body of men to exercise corporate franchises, that is, to determine the right of a pretended corporation to exist at all, yet it is equally used, as already seen,[3] to try the title of corporate officers to their offices. In the former case it is regarded as a proceeding by the State; in the latter as a contest by private individuals;[4] and in either case, it may confidently be assumed, the court will decide every question of

[1] Penn. Act, June 16, 1836, § 13.

[2] Tunis *v.* Hestonville &c. R. Co., 149 Pa. St. 70; *s. c.* 15 L. R. A. 665; 24 Atl. Rep. 88 (affirming 1 Pa. Dist. Rep. 135, 207). In Gowen's Appeal, 10 Week. Not. Cas. (Pa.) 85, a master was appointed by the Court of Common Pleas of Philadelphia, to preside at and supervise the proceedings of a meeting of the Philadelphia and Reading Railroad Company.

[3] *Ante*, § 766.

[4] *Ante*, § 767; *post*, ch. 157.

law involved in the final result, including constitutional questions,[1] though a different rule prevails in some States.[2]

§ 3880. Reviewing Such Elections under New York Statute. — A *summary proceeding* has long existed in New York for reviewing upon *motion* in the Supreme Court all elections in private corporations.[3] This statute has been held *not unconstitutional* as involving a deprivation of the right of *trial by jury.*[4] *Notice* of such a motion to the person who claims to have been elected, and to the corporation, is sufficient. It is not necessary that all the stockholders should have notice.[5] Nor need it be served on the president, nor on the directors whose election is not questioned, nor on the persons whose right to vote is denied.[6] As in ordinary proceedings, counsel on both sides, who appear on such motion, will be deemed, *prima facie,* to be authorized to appear. But any person, named as a relator, may move to have his name struck from the proceeding, if he did not authorize the application.[7]

§ 3881. Under California Statute. — Under a similar statute of California, authorizing an inquiry by the district court on the application of any person or body corporate "aggrieved by any election held by any corporate body," etc.,[8] the word "*election*" does not include a mere *appointment* by the directors to fill a vacancy; and one displaced by such an appointment is not "aggrieved by any election by a corporate body," within the meaning of the statute, so as to confer upon the court jurisdiction to make the inquiry.[9]

[1] Taggart *v.* Perkins, 73 Mich. 303; *s. c.* 41 N. W. Rep. 426; People *v.* Maynard, 15 Mich. 463; Attorney-General *v.* Amos, 60 Mich. 372; *s. c.* 27 N. W. Rep. 571; People *v.* Jackson &c. R. Co., 9 Mich. 285; People *v.* Holihan, 29 Mich. 116.

[2] See, for instance, People *v.* Whitcomb, 55 Ill. 172.

[3] Rev. Stat. N. Y., tit. 4, ch. 18, § 5.

[4] Re Newcomb, 42 N. Y. St. 442; *s. c.* 18 N. Y. Supp. 16.

[5] Schoharie Valley R. Co.'s case, 12 Abb. Pr. (N. S.) (N. Y.) 394.

[6] Ex parte Holmes, 5 Cow. (N. Y.) 426.

[7] *Ibid.* Corporation must have notice where the application is for a *new election* under New York Laws 1890, ch. 563, § 15. People *v.* Simonson, 18 N. Y. Supp. 37; *s. c.* 27 Abb. N. Cas. 422. When denial of order for new election no bar to a subsequent application: Re Townshend, 18 N. Y. Supp. 905.

[8] Cal. Civ. Code, § 315.

[9] Wickersham *v.* Brittan, 93 Cal. 34; *s. c.* 15 L. R. A. 106; 28 Pac. Rep. 792.

§ 3882. Persons Suing for the Office must Prove Qualification.—If a statute, by-law, or other governing instrument annexes a qualification to the office, the person suing for the possession of it must prove that he possesses that qualification.[1]

§ 3883. Directors Suing at Law must Show Title.—Where a corporation sues in its corporate name, it must of course *allege* its corporate character; but formal proof of this is generally dispensed with, under the operation of a principle of estoppel already and hereafter considered.[2] But where the directors of a joint-stock company sue, not as a corporation, but as directors, they stand in the position of an executor, who must not only *allege his representative character*, but must also prove it by the production of his letters testamentary. It lies, then, upon plaintiffs, *suing as directors*, to show that they are such directors; and, if one who was also a director is *omitted*, to show that his character of director has legally *determined.*[3]

§ 3884. Evidence to Prove Such Title: Adoption: Recognition.—The rule is, that not only the appointment but the authority of an *agent* of a corporation may be implied from the adoption or recognition of his acts by the corporation.[4] This rule extends beyond the case of mere subordinate agents; so that if a corporation elect a person a *director*, who is ineligible to that office, and permit him to act as such, the corporation will be bound by the acts which he performs, within the scope of the authority possessed by a director.[5]

§ 3885. Evidence to Prove Acceptance of the Office.—On the other hand, where it is sought *as against an alleged director*,

[1] Tufton *v.* Nevinson, 2 Ld. Raym. 1354.

[2] *Ante*, § 518; *post*, ch. 184.

[3] Phelps *v.* Lyle, 2 Per. & D. 314; *s. c.* 10 Ad. & El. 113; 3 Jur. 479.

[4] Ang. & Ames Corp., § 284; Kiley *v.* Forsee, 57 Mo. 390, 396; Southgate *v.* Atlantic &c. R. Co., 61 Mo. 89, 94; *post*, § 4881.

[5] Despatch Line *v.* Bellamy Man. Co., 12 N. H. 205; *s. c.* 37 Am. Dec. 203; *post*, § 3893, *et seq.*

and in order to charge him with acts done in that character, to prove his acceptance of the office, an analogy is found in the usual mode of proving corporate existence,[1]—a grant of corporate privileges and user thereunder; which in this case would require proof, by the corporate records, of an election as director, and by other competent evidence, parol or otherwise, of the exercise of the functions of the office. Thus, it has been held that the *records* of a corporation, showing the election at an annual meeting of a certain person as director, and his presence, and *making motions* at a subsequent meeting of the directors, are admissible as *prima facie* evidence, though not conclusive, of his acceptance of the office, in an action of tort brought by him against a sheriff for levying an execution against the corporation on his property as a director.[2] Such evidence may, no doubt, be rebutted by showing a distinct declination of the office before the facts which gave rise to the supposed liability took place.[3]

§ 3886. Resignation or Abandonment of the Office.— Closely allied to this is the question, what will be sufficient evidence of the *resignation* of a director who has already accepted the office; and here the law is, that *no writing* and no precise form of words is necessary, but that an effectual resignation may be made by *acts* and *declarations*, as well as

[1] *Ante*, § 220; *post*, ch. 184, art. III.

[2] Blake *v.* Bayley, 16 Gray (Mass.), 531.

[3] This may be illustrated by a case where a person, on being invited to become a director in a banking company, consented, provided he should be satisfied that a certain proportion of the capital had been subscribed, and that certain persons, named in the prospectus as directors, would actually become such. He attended one meeting of the board, and joined in signing a check with another director; but, on receiving, a few days afterwards, a letter of allotment of the shares necessary to qualify him, at once returned it, declining to act as director, or to receive the shares, for the reason that he was not satisfied upon the two points stipulated by him. The secretary wrote back, saying that his resignation had been accepted. It was held that he was not liable as contributory. Austin's case, L. R. 2 Eq. 435. As to what is sufficient *dissent* from appointment as a director or committee-man, to prevent one from being liable as such,—see further, Fulton Bank *v.* New York &c. Can. Co., 4 Paige (N. Y.), 127.

by the most formal document. It may be made *orally* to the president of the corporation when the declaration is accompanied by the act of selling and transferring all the shares of the director.[1] So, where a director executed an assignment of all his shares to one who held the office of *secretary and treasurer* of the corporation, and at the same time declared to him that he severed all connection with the company and would have nothing more to do with it, but omitted to request that his resignation should be communicated to the board of directors, — this was held an effectual resignation.[2]

§ 3887. Abandonment or Forfeiture by Reason of Becoming Disqualified. — Such a resignation may be made by *acts*, as well as by words; or, more properly speaking, it may take place by implication of law, — as by becoming disqualified, or by accepting another incompatible office, and the like. In such cases it is, perhaps, more correct to say that the office has been abandoned or forfeited. Thus, where church membership is a necessary qualification of the trustees, who are to manage the affairs of a religious corporation, a trustee who withdraws himself from the church, and joins a church of another denomination, which latter church prohibits a connection by its members with the former, will be considered as having *abandoned his office* of trustee, and as having no further interest in the property of the church he has left.[3] So, it seems that an officer of a corporation will forfeit his office at common law, by the act of accepting an office which is incompatible with the former, — as where the office to which the person is advanced is of such a nature as to make him judge over his conduct in the office from which he has been advanced. Thus, where a town clerk had been elected one of the jurats and mayor of the town, and was for that cause

[1] Briggs *v.* Spaulding, 141 U. S. 132.

[2] Chemical Nat. Bank *v.* Colwell, 132 N. Y. 250; *s. c.* 30 N. E. Rep. 644; 43 N. Y. St. Rep. 876 (reversing *s. c.* 29 N. Y. St. Rep. 725; 9 N. Y. Supp. 288). Circumstances under which *participating in a new election* by a director does not amount to a resignation of his office. Berry *v.* Cross, 3 Sandf. Ch. (N. Y.) 1.

[3] Ross *v.* Crockett, 14 La. An. 823.

turned out of office, a *mandamus* to restore him was refused, because, in his character of clerk, he was a servant attending on the mayor or jurats and the like officers; and the case was likened to that of a guardian of a forest who is made a justice of the peace. It was said to be a surrender of his former office, because he could not judge of his own forfeiture, nor punish his own laches.[1] But the individual *bankruptcy* of a person who is a stockholder in, and a director and officer of, a corporation which is not in bankruptcy, does not incapacitate him from exercising his functions as such officer, nor render inoperative and void, as to third parties, the acts and conveyances done and executed through him as its representative.[2] Therefore, it has been held that a director in a joint-stock company, who has become *bankrupt,* must nevertheless be *joined as plaintiff* in an action of *assumpsit* by the directors, even although he has ceased to act, unless it be shown that he had vacated his office; since a director, by becoming bankrupt and ceasing to act, does not cease to be a director, unless in pursuance of the provisions of the governing instrument.[3] Where the statute or other governing instrument provides that, in order to be qualified for the office of director, a person must be the holder of a stated number of shares, it seems to be a reasonable conclusion that whenever a director makes an out-and-out transfer to another of all his shares in the corporation, and the transfer is effectuated by being noted on the books of the corporation, or if there are no books, by being notified to the corporation,—he thereby, *ipso facto,* ceases to be a director and incurs no further liability as such.[4]

[1] Rex *v.* Sandwich, 2 Keb. 92.

[2] Atlas Bank *v.* Gardner Co., 8 Biss. (U. S.) 537.

[3] Phelps *v.* Lyle, 2 Per. & D. 314; *s. c.* 10 Ad. & El. 113; 3 Jur. 479.

[4] Chemical Nat. Bank *v.* Colwell, 132 N. Y. 250; *s. c.* 30 N. E. Rep. 644 (Bradley, J., dissenting). But compare Nathan *v.* Tompkins, 82 Ala. 437; *s. c.* 2 South. Rep. 747. That disqualification is no ground upon which a corporate officer can refuse to deliver the books and papers of the office to his successor, see Crawford *v.* Powell, 2 Ld. Raym. 1013, 1016; *s. c.* 1 W. Black. 229.

CHAPTER LXXIV.

DIRECTORS AND OFFICERS DE FACTO.

SECTION
3893. General statement of doctrine.
3894. Who are directors *de facto.*
3895. Persons ineligible to the office.
3896. Who are not directors *de facto.*
3897. Title to office cannot be impeached collaterally.

SECTION
3898. What if two boards are in existence and acting.
3899. Acts of directors *de facto* bind the stockholders.
3900. Cases showing the extent of protection under the rule.
3901. Personal liability of *de facto* directors.

§ **3893. General Statement of Doctrine.** — The acts of those who publicly exercise the functions of directors and other officers [1] of private corporations are upheld on the same principle which upholds the acts of *de facto* public officers and *de facto* corporations.[2] As a general rule, they are deemed valid in respect of third persons,[3] in respect of the corporation,[4] in respect of its shareholders,[5] and in respect of the directors themselves.[6] The reasons which uphold the validity of their acts are twofold: 1. The injustice of requiring those who are obliged to deal with corporations to investigate and decide at their peril whether those who are in the actual exercise of the functions of corporate offices are rightfully there; 2. The inconvenience of litigating the title to such offices in collateral

[1] *E. g.*, general manager: Hamm *v.* Drew, 83 Tex. 77; *s. c.* 18 S. W. Rep. 434.

[2] *Ante*, § 495, *et seq.*

[3] It is perhaps better to say that their acts are binding on the corporation to the extent of the rights of third persons. Hall *v.* Carey, 5 Ga. 239; *post*, § 3900.

[4] Cahill *v.* Kalamazoo Mut. Ins. Co., 2 Dougl. (Mich.) 124; *s. c.* 43 Am. Dec. 457; Despatch Line *v.* Bellamy Man. Co., 12 N. H. 205; *s. c.* 37 Am. Dec. 203; Burr *v.* M'Donald, 3 Gratt. (Va.) 215.

[5] Rockville &c. Turnp. Road *v.* Van Ness, 2 Cranch C. C. (U. S.) 449.

[6] Compare *post*, § 3901.

proceedings.[1] Although this title is devoted specially to the subject of *directors*, yet the principle under discussion applies equally to other corporate *officers*, such as the *president*[2] and the *treasurer*.[3] The rule is analogous to that which relates to the validity of the acts of public officers and of officers of municipal corporations. Thus, a person who comes into the office of a municipal corporation under color of an election is admitted to be an officer *de facto*, and his acts are valid so far as third persons are concerned; and the regularity of his election cannot be inquired into except in some direct proceeding in which he is a party.[4] Indeed, the principle very much resembles the rule of evidence which obtains in proving *agency*, under which such a relation may be shown, by evidence that the alleged agent *held himself out* as such, with the knowledge and consent of the person sought to be charged as his principal.[5] Thus, although the person may be *disqualified for the office*,[6] yet by electing him as a director and permitting him to act as such, the corporation holds him out to the world as a director,—as one of its agents having all the powers of an agent of that description and to be trusted as such. It is only necessary, under such circumstances, for those who deal with the corporation through him, to inquire what powers directors of the corporation have, and what acts the corporation has authorized them to do. They are not required to investigate the qualifications which the corporation has prescribed to itself as the condition upon which any one should be elected a director or permitted to act as such. The corporation, and not the general public, have the means of knowing whether a director, whom they have elected as such, is qualified to act as a director according to their by-laws. If he is not qualified

[1] There is a valuable note on the subject of *de facto* officers of private corporations in 19 Am. & Eng. Corp. Cas. 160.

[2] Cahill *v.* Kalamazoo Mut. Ins. Co., 2 Dougl. (Mich.) 124; *s. c.* 43 Am. Dec. 457.

[3] Vernon Society *v.* Hills, 6 Cow. (N. Y.) 23, 26; *s. c.* 16 Am. Dec. 429; All Saints Church *v.* Lovett, 1 Hall (N. Y.), 191.

[4] Tucker *v.* Aiken, 7 N. H. 113, 135.

[5] *Post*, § 4881; Davis *v.* Lane, 10 N. H. 156; Beard *v.* Kirk, 11 N. H. 397.

[6] *Post*, § 3895.

at the time of his election, it is within their power to require him either to possess himself of the requisite qualifications, or else to proceed to another election. If, instead of doing this, they leave his election as a director upon record as though he were at law eligible, and thus hold him out and permit him to hold himself out as a director, and he acts as such, they are bound by his acts as fully as though he were properly qualified.[1]

§ **3894. Who are Directors de Facto.**—Persons publicly exercising the functions of directors of private corporations have been held to be directors within the foregoing principle, where they were elected for a fixed term and were *holding over* after its expiration,[2] and it should be added that such directors are directors *de jure;*[3] where the *election* at which they were chosen was held *outside* the limits of the *State* by which the charter was granted;[4] or where a judicial decision had been rendered removing them from their offices, but, on the same day and before the judgment had been filed and recorded, they met and executed a note for the company.[5] And where one was elected to be an officer of a banking corporation, by the body in which the right to elect was vested, but by a *less number* than the charter required, it was held that he was an officer *de facto*, and that his acts were good, at least as respected third persons.[6] As the *status* of such officers depends upon a fact or collection of facts *in pais*, namely, upon the fact of their acting publicly in the exercise of the office, and upon the *presumption* of rightfulness of tenure which springs from

[1] Despatch Line *v.* Bellamy Man. Co., 12 N. H. 205; *s. c.* 37 Am. Dec. 203. That the provision of the English Companies Act, 1862, art. 58, table A, that "at the first ordinary meeting after the registration of the company the whole of the directors shall retire from office does not apply to *de facto* directors," etc., see Morley Building Co. *v.* Barras [1891], 2 Ch. 386.

[2] Thorington *v.* Gould, 59 Ala. 461.

[3] *Ante*, §§ 792, 3851.

[4] Ohio &c. R. Co. *v.* McPherson, 35 Mo. 13; *s. c.* 86 Am. Dec. 128.

[5] Mining Co. *v.* Anglo-Californian Bank, 104 U. S. 192.

[6] Baird *v.* Bank of Washington, 11 Serg. & R. (Pa.) 411.

such fact,[1] it follows that *parol evidence* is admissible to show such acting.[2]

§ **3895. Persons Ineligible to the Office.**—Although a person may have been elected a director of a corporation, who was not eligible for the office under the by-laws, because, not a proprietor or shareholder, yet, if he be permitted to act, and be held out to the public as a duly authorized director, the validity of his acts cannot be questioned in a collateral proceeding.[3] The rule applies with increased force where the corporation itself, in some collateral proceeding in which a third person is interested, attempts to impeach the acts of its own director on the ground that he was ineligible for the office; for a director is but an agent or trustee of a corporation, and it is a settled rule that a person is bound by the acts of another whom he has held out to the world as his agent for that purpose.[4] It also applies in its full extent, where a creditor of a corporation is contesting a mortgage of corporate property as against the mortgagee.[5] So a director who *ceases to be a stockholder* during the term for which he was chosen, but continues to act as director, no judgment of ouster having been pronounced against him, is a director *de facto*, and his acts are valid as to third persons.[6] So, although the president and managers of the Pennsylvania Coal Company were, at the time of the making of an agreement with the Hudson and Delaware Canal Company, for the use of the canal of the latter, at a reduced rate of tolls, citizens of the State of New York, and not of Pennsylvania, and therefore ineligible as officers, yet the agreement was not, for that reason, invalid, as against the canal company, who, by the agree-

[1] Hall *v.* Carey, 5 Ga. 239.

[2] Cahill *v.* Kalamazoo Mut. Ins. Co., 2 Dougl. (Mich.) 124; *s. c.* 43 Am. Dec. 457.

[3] Despatch Line *v.* Bellamy Man. Co., 12 N. H. 205; *s. c.* 37 Am. Dec. 203.

[4] Davis *v.* Lane, 10 N. H. 156; Beard *v.* Kirk, 11 N. H. 397; *post*, § 4881.

[5] Despatch Line *v.* Bellamy Man. Co., 12 N. H. 205; *s. c.* 37 Am. Dec. 203.

[6] San Jose Savings Bank *v.* Sierra Lumber Co., 63 Cal. 179.

ment, *recognized* such persons as officers *de facto*.[1] A recent decision in New York is cited to the proposition that a person elected director of a corporation, in violation of a statute declaring him ineligible, cannot be a director *de facto*, but another director may be chosen in his place.[2] That a qualified person may be chosen director in the place of one who is disqualified, is clear; but until he is displaced by a qualified person, his acts in respect of third persons will certainly be upheld, on the principle laid down by Lord Mansfield that the election of a disqualified person is not wholly void, but is only voidable.[3]

§ **3896. Who are not Directors de Facto.** — There is, however, a limit to the principle which upholds the acts of directors and other corporate officers *de facto*. The mere fact that a number of gentlemen *claim* to be directors of a corporation for the purposes of a single act or transaction, does not validate their act on this principle; otherwise the funds of no corporation would be safe from spoliation by interlopers. Nor will such an act become the act of *de facto* directors from the further fact, without more, that such persons have *once been directors*. We have seen that the office of a director may be vacated by *resignation*[4] or *abandonment*.[5] And where there has been an abandonment for many years, by the last board of directors of a corporation, of their official functions, and they thereafter meet, and attempt to do an official act, it will not be upheld as the act of directors *de facto*. This statement may be illustrated by a case where the trustees and stockholders of a corporation sold to A. the entire stock of the corporation, and delivered to A. all of the property of the corporation. A. remained in possession of the property for three years, openly using and managing it, and then sold out to others. The trustees closed up their accounts after the

[1] Delaware &c. Canal Co. *v.* Pennsylvania Coal Co., 21 Pa. St. 131.

[2] Re Newcomb, 42 N. Y. St Rep. 442; *s. c.* 18 N. Y. Supp. 16.

[3] *Ante*, § 806; Crawford *v.* Powell, 2 Ld. Raym. 1013, 1016; *s. c.* 1 W. Black. 229.

[4] *Ante*, § 3386.

[5] *Ante*, § 3387.

sale, and did no further act as trustees until, *three years afterwards*, the majority of them *met* and allowed an account, and drew a check in B.'s favor. It was held that they were not then trustees, either *de jure* or *de facto*, and that the corporation could not be held liable by reason of the check, especially as B. was not misled.[1]

§ 3897. Title to Office cannot be Impeached Collaterally. We have seen that one of the grounds for upholding the acts of directors and other corporate officers who are exercising the functions of their offices in fact, though not rightfully, is the practical inconvenience in judicial administration of litigating the question of the rightfulness of their tenure of their offices in collateral proceedings. This principle has been carried very far by some courts, and restrained by others. Courts have often held, in conformity with a doctrine already considered,[2] that the title of directors of a corporation, who are in under color of an election, cannot be inquired into in a suit in equity instituted to *restrain* them from exercising the functions of directors, upon the ground of an irregularity in their election.[3] So, it has been held that the right of *de facto* directors of a corporation to act as directors cannot be questioned collaterally, in an action to try the title of *their appointee* to his office[4]. On the same ground upon which the courts proceed in holding that a person, when sued by a corporation, cannot set up that the corporation has been dissolved by misuser or non-user of its franchises,[5] it is held that, in such an action, the defendant cannot set up that the trustees, in a case

[1] Orr Water Ditch Co. *v.* Reno Water Co., 17 Nev. 166. In another case, the charter of a bank provided that the directors should remain in office until their successors should be elected. An election for bank officers took place at a time when the corporation was insolvent, and for *sixteen years* no corporate acts were performed. It was held that the directors could not be deemed to have continued in office, their neglect to perform any duty for so long a time being equivalent to an *abandonment* or *resignation* of the office. Bartholomew *v.* Bentley, 1 Ohio St. 37.

[2] *Ante*, § 764. Compare § 826.

[3] Hughes *v.* Parker, 20 N. H. 58.

[4] People *v.* Hills, 1 Lans. (N. Y.) 202.

[5] *Ante*, § 531.

where the corporation consists of the trustees, were not regularly elected. He can only set this up by showing that proceedings have been instituted against them by the government and carried on to a judgment of ouster.[1] It does not follow, from the foregoing, that the question, who are rightfully the trustees of a *religious corporation*, cannot be in any case litigated in a collateral proceeding. Where, for instance, an action of *forcible entry and detainer* was brought by trustees against other members of the society for breaking into the church, it was held that the sole question was, who were in fact the trustees; since if the defendants were the trustees and not the plaintiffs, there was no breaking.[2] But, contrary to this, it has been held that a board of directors, *de facto*, in possession of the franchises of the corporation, may maintain an action against persons claiming to be the board, for any trespass respecting the corporate property,—the reason being that the acts of such *de facto* officers cannot be impeached collaterally, but only by *quo warranto*.[3]

§ 3898. What if Two Boards are in Existence and Acting. Where two boards of directors are in existence at the same time, each claiming to be the rightful board, and acting or pretending to act as such, it is difficult to extend the principle under discussion so far as to conclude that *either* or *both* of these boards may be regarded, even for the purpose of upholding the rights of third persons, as directors *de facto*. The very circumstance of two boards being in existence and acting under a claim of right gives warning to the public that the rightful authority of each is challenged by the other, and is hence in dispute within the corporation; and this should seem to require the public to choose between them at their peril.

[1] Vernon Society *v.* Hills, 6 Cow. (N. Y.) 23; *s. c.* 16 Am. Dec. 429.

[2] People *v.* Runkle, 8 Johns. (N. Y.) 464; *s. c.* 9 Johns. (N. Y.) 147. The celebrated Dartmouth College decision began in an action of *trover* by one set of trustees, suing as the corporation, against one claiming the office of secretary and treasurer, under statutes of New Hampshire, to recover the records of the college.

[3] Atlantic &c. R. Co. *v.* Johnston, 70 N. C. 348. Compare Walker *v.* Flemming, 70 N. C. 483.

Somewhat in line with this thought is a decision of the Supreme Court of Indiana in a case where the statute governing gravel-road corporations authorized the loan of money to such a corporation by an officer thereof, and the giving of a promissory note therefor, but where such a note was given to its *president de facto* only, and signed by him and by others who were only officers *de facto*, holding over after the lawful election of others,—the court holding that the loan was unauthorized and the note invalid.[1] In a case in another court the action of a board of directors *de facto*, which has been ratified by the subsequent action of the corporation, was held valid, although, after their election but before the action was taken, another board of directors had been chosen, no evidence being offered that the second board had ever accepted their trust.[2]

§ 3899. Acts of Directors de Facto Bind the Stockholders. The principle under discussion extends so far that the acts of directors *de facto* bind the stockholders, not only in favor of third persons, but also in favor of the corporation. Thus, in a case affecting the rights of *creditors* of the corporation, it has been held by a respectable court that an assignment for creditors by the directors of a corporation is *binding on the stockholders*, although made without their previous consent, and cannot be set aside at their instance in a collateral proceeding, on the ground that some of the directors were not legally elected.[3] So, where the corporation sues its stockholder for an *assessment* on his shares, it is not only not incumbent on the plaintiff to prove that its managers were elected by a majority of the votes,[4] but it is no defense that the board of directors by which the call was made is an illegal body, because elected at a meeting convened beyond the limits of

[1] Lebanon &c. Gravel Road Co. *v.* Adair, 85 Ind. 244.

[2] Penobscot &c. R. Co. *v.* Dunn, 39 Me. 587.

[3] Boardman *v.* Keystone Standard Watch Co., (Pa. C. P.) 8 Lanc. L. Rev. 25.

[4] Rockville &c. Turnpike Road *v.* Van Ness, 2 Cranch C. C. (U. S.) 449.

the State creating the corporation.[1] So, in an action for calls in an English court, the defendant applied to set aside the proceedings on the ground that the action had been brought without authority, as the company had ceased to exist. The court held that, as the cause had been set down for trial, and the defendant had known the facts for a long time, the application was too late; and that, as the persons authorizing the action had for some time acted as directors, the validity of their appointment could not be questioned on such an application.[2]

§ 3900. Cases Showing the Extent of Protection under the Rule. — The appointment of an officer of the corporation by a *de facto* board of directors or trustees, has the same effect in law as where made by a legal board.[3] For reasons equally strong, a contract of employment, either as a servant or as an independent contractor, will entitle the party engaging to perform the service, to the agreed compensation, although the contract may have been made with officers of the corporation who were such *de facto* only.[4]

§ 3901. Personal Liability of de Facto Directors. — Persons acting as directors or other corporate officers without right, are subject to all the personal liability which attaches to the rightful incumbents of such offices, whether by the common, the equitable, or the statute law.[5] Thus, under a

[1] Ohio &c. R. Co. *v.* McPherson, 35 Mo. 13; *s. c.* 86 Am. Dec. 128.

[2] Thames Haven Dock &c. Co. *v.* Hall, 3 Eng. Railw. Cas. 441.

[3] Ellis *v.* North Carolina Inst. for the Deaf and Dumb, 68 N. C. 423.

[4] Wilson *v.* Kings County Elevated R. Co., 114 N. Y. 487; *s. c.* 21 N. E. Rep. 1015; 24 N. Y. St. Rep. 81; 6 Rail. & Corp. L. J. 324; 40 Alb. L. J. 346.

[5] Halstead *v.* Dodge, 51 N. Y. Super. 169; Newcomb *v.* Reed, 12 Allen (Mass.), 362; Squires *v.* Brown, 22 How. Pr. (N. Y.) 35. In this they are, like *executors de son tort*, subject to the burdens of the office, but without being entitled to any of its benefits, if such there be. The reason is that, in order to escape personal responsibility for their official acts, they will not be permitted to set up their own wrong in holding an office to which they were not elected or appointed, or to which they were ineligible. The principle may be illustrated by a case where the officers were not directors of the corporation,

statute of New York relating to manufacturing companies,[1] making directors personally liable for debts of the corporation in consequence of their failure to *file a certain prescribed report*,[2] it will be sufficient that he was a trustee *de facto* at the time the debt was contracted. If he was a trustee *de jure* at the time when the reports required by the statute should have been filed, it will be no defense that his term of office as trustee had expired at the time the debt was contracted, it appearing that no new trustees had been elected and that he had subsequently acted as trustee.[3] But where a trustee has sent in his *resignation*, and thereafter ceases to act as a trustee, his liability ceases from that time, although his resignation may not have been accepted.[4] Nor will one who acted as *president* of a corporation, and who has become liable under such a statute, be heard to urge that he was irregularly elected to the office.[5]

but trustees in a railway mortgage, in possession and operating the road. In an action against them to recover for the loss of freight, it was held sufficient to show that they acted as such trustees, and had control and management of the road; it was not necessary to show that they were actually trustees. Pearson *v.* Wheeler, 55 N. H. 41.

[1] Laws N. Y. 1848 and 1854, §§ 4, 12.

[2] *Post*, § 4221, *et seq.*

[3] Deming *v.* Puleston, 55 N. Y. 655; affirming *s. c.* 35 N. Y. Super. 309; Reed *v.* Keese, 37 N. Y. Super. 269; *s. c.* affirmed, 60 N. Y. 616; Sanborn *v.* Lefferts, 16 Abb. Pr. (N. Y.) 42. This case overrules in effect the case of Crawford *v.* Easterly, 4 Lans. (N. Y.) 513, where it was held that the trustee who, with his own consent, had been elected in the place of another whose office had not been vacated, and who served as such trustee, was not chargeable under the statute, because he was not a trustee *de jure*, and was not estopped from setting up the defense that he was not a trustee. Talcott, J., dissented, and well he might, for there was no sense whatever in the conclusion of the majority.

[4] Chandler *v.* Hoag, 5 Thomp. & C. (N. Y.) 197; *s. c.* 2 Hun (N. Y.), 613.

[5] Steam Engine Co. *v.* Hubbard, 101 U. S. 188. Compare Bartholomew *v.* Bentley, 1 Ohio St. 37.

CHAPTER LXXV.

QUORUM OF DIRECTORS AND NUMBER THAT CAN ACT.

SECTION
3904. Preliminary.
3905. Directors must act together as a board.
3906. Individual directors have no authority as such.
3907. But may be agents by special appointment.
3908. Separate assent of a majority not binding.
3909. Cannot vote at board meetings by proxy.
3910. Where the act is private all must join: where it is public a majority may act.
3911. Rule as to public acts applicable to private corporations: a majority of the directors rule.
3912. Distinction between a select and indefinite body in respect of a quorum.
3913. Majority of all the directors necessary to a quorum.
3914. But a majority of the assembled quorum may act.
3915. Acts at board meeting without a quorum voidable.
3916. Must be a quorum of each integral part.
3917. Rule in case of unfilled vacancies.
3918. In the case of a special committee a majority of all must concur.
3919. Effect of the disqualification of a member of the quorum.
3920. What is a quorum where the directory has been enlarged by a consolidation with another corporation.

SECTION
3921. By-law fixing quorum at less than a majority.
3922. Whether *ex officio* trustees not a part of the quorum.
3923. Number that may act in ministerial matters.
3924. Acts of directory composed of excessive number.
3925. Directors no power to exclude some of their board.
3926. Presumption in favor of regular action.
3927. Extent of this presumption.
3928. Ratification of acts done by less than the requisite number.
3929. Power of a quorum to contract with their own members.
3930. Place of the president in the quorum.
3931. When take the sense of the stockholders.
3932. Majority can act only at a regular meeting.
3933. Meet outside the State.
3934. When record need not affirmatively show notice.
3935. Manner of assembling the meeting.
3936. When notice of the meeting must be given.
3937. Notice of adjourned meetings must be given.
3938. These principles varied by corporate usage.

§ **3904. Preliminary.** — The subject of corporate meetings has been considered in a former chapter,[1] and many of the principles there laid down are applicable to the subject of meetings of directors and acts performed by them. The two chapters should be read together. It should be kept in mind that the *statutes* in many of the States prescribe what shall constitute a quorum of a board of directors of a corporation, — making it generally either a *majority of the directors*,[2] or a *majority of the stock*.[3]

§ **3905. Directors must Act Together as a Board.** — We may settle down with confidence upon this principle, — that in all matters involving the exercise of what might be termed a *legislative or judicial discretion*, and which the directors cannot therefore *delegate* to others, as elsewhere shown,[4] they can only bind the corporation by *acting together as a board*.[5] A *majority* of them cannot undertake to act in their individual names for the board itself, and no act can be done affecting the ownership of property, except by a resolution of the board when regularly constituted and sitting in consultation.[6] It has been held that a *deed signed by every member* of a board of directors, but not in pursuance of any resolutions of the signers as a board, will not pass the title of the corporation.[7] Nor can an act invalid as against the corporation be *ratified* "by individual consent of a majority of the board."[8]

[1] *Ante*, § 686, *et seq.;* also, § 700, *et seq.* There is a note on the subject of this chapter, collecting American decisions, in 19 Am. & Eng. Corp. Cas. 128.

[2] As in 1 Gen. Stat. Kan., § 1174.

[3] As in Gen. Stat. Col. 1883, ch. 19, § 6.

[4] *Post*, § 3944, *et seq.*

[5] *Post*, § 3950. Compare Tenney *v.* East Warren Lumber Co., 43 N. H. 343.

[6] Ross *v.* Crockett, 14 La. An. 823; Constant *v.* St. Albans Church, 4 Daly (N. Y.), 305; Cammeyer *v.* United German Lutheran Churches, 2 Sandf. Ch. (N. Y.) 186, 230.

[7] Baldwin *v.* Canfield, 26 Minn. 43. A deed signed by the holder of all the stock of a corporation with intent to pass the corporate title has been held void upon its face, and needs no interposition of a court of equity to declare it so. *Ibid.* But that such a deed may be *effectuated in equity*, see *post*, §§ 5096, 6202.

[8] First Nat. Bank *v.* Drake, 35 Kan. 564; *s. c.* 57 Am. Rep. 193. See, further, First Nat. Bank *v.* Christopher, 40 N. J. L. 435; *s. c.* 29 Am. Rep. 262;

§ 3906. Individual Directors have No Authority as Such. Individual *stockholders*, as we have seen,[1] are, in theory of law, strangers to the corporation, and are not, in their character of stockholders, agents for it in any sense, as a partner is an agent for his firm. And although there are cases where the act or contract of all the stockholders is deemed tantamount to the act or contract of the corporation,[2] yet the general rule is that a stockholder is not a *part owner* of the property of the corporation, but that the corporation, considered as an intangible person, is the *sole owner*, and that its property and business are subject to the management and control of its

Junction R. Co. *v.* Reeve, 15 Ind. 236; Re Marseilles R. Co., L. R. 7 Ch. 161; Schumm *v.* Seymour, 24 N. J. Eq. 143; Edgerly *v.* Emerson, 23 N. H. 555; *s. c.* 55 Am. Dec. 207; Stoystown &c. Turnp. R. Co. *v.* Craver, 45 Pa. St. 386; Keeler *v.* Frost, 22 Barb. (N. Y.) 400; Aikman *v.* School District, 27 Kan. 129; Mincer *v.* School District, 27 Kan. 253; Anderson Co. *v.* Paola &c. R. Co., 20 Kan. 534; Paola &c. R. Co. *v.* Anderson Co., 16 Kan. 302; Herrington *v.* District Township, 47 Iowa, 11; McCortle *v.* Bates, 29 Ohio St. 419; *s. c.* 23 Am. Rep. 758. Note to Edgerly *v.* Emerson, 23 N. H. 555; *s. c.* 55 Am. Dec. 207, 221.

[1] *Ante*, § 1071; also *post*, § 4460.

[2] Thus, it has been held that a contract made by the stockholders of a mining corporation as parties of the first part, by which the stockholders agree to assign their stock to trustees, to be by the trustees conveyed to the parties of the second part, upon the payment by them of a certain sum of money to the parties of the first part, through the trustees, accompanied by a resolution of the board of directors of the corporation authorizing their president to convey the mine to the parties of the second part upon the payment of the money, is substantially as if the contract had been made with the corporation instead of the stockholders. Gordon *v.* Swan, 43 Cal. 564. So, where a bill for injunction averred that a certain agreement, though signed only by the stockholders of defendant company, was in fact executed for and on behalf of the company, and that the stockholders were duly authorized and empowered to act for the company, and that the company had received the proceeds of the consideration of such agreement, it could not be held on demurrer that the company was not bound by the agreement simply because its name was not appended thereto, and such agreement purported to be only the individual undertaking of certain stockholders. American Preservers' Trust *v.* Taylor Man. Co., 46 Fed. Rep. 152. So, the act of *all the stockholders* in transferring their shares to a "*voting trust*" is tantamount to an act of the corporation, for which it will forfeit its charter. *Post*, § 6412. And so the assent, acquiescence, or non-action of all the members of a corporation will sometimes create a *ratification*. *Post*, § 5314, *et passim*.

directors, and not of its individual stockholders.[1] The *declarations* of an individual stockholder do not therefore bind the corporation.[2] The *board* of directors to whom the authority to bind the corporation is committed, is not the individual directors scattered here and there, whose assent to a given act may be collected by a diligent canvasser, but it is the board sitting and consulting together as a body.[3] Individual directors, or any number of them less than a quorum, have no authority, as directors, to bind the corporation.[4] And this is equally the rule although the director who assumes to do so may own a majority of the shares.[5] So, it has been held that the action of a *committee* appointed in pursuance of the *by-laws* of a corporation, to *audit the accounts* of the treasurer and all other financial accounts of the corporation, is not conclusive upon the corporation until the same has been *accepted* and adopted by the board of directors; nor even then, where it appears that, at such acceptance before the board, of which the committee were members, one of the votes of such committee was required to make a majority.[6] So, it has been held that the *presence*, in an unofficial capacity, of *two directors* of a corporation, at an interview between a

[1] Fitzgerald *v.* Missouri &c. R. Co. (Neb.), 45 Fed. Rep. 812. Hence, a corporation is not liable for work performed on its property under a contract made with the *owner of most of its stock* and franchises, individually, in the absence of evidence of authority from or ratification by the corporation. Donoghue *v.* Indiana &c. R. Co., 87 Mich. 13; *s. c.* 49 N. W. Rep. 512.

[2] Mitchell *v.* Rome R. Co., 17 Ga. 574; Canal Bank *v.* Holland, 5 La. An. 363.

[3] Filon *v.* Miller Brew. Co., 38 N. Y. St. Rep. 602; *s. c.* 15 N. Y. Supp. 57.

[4] Bank of Healdsburg *v.* Bailhache, 65 Cal. 327; Browning *v.* Hinkle, 48 Minn. 544; *s. c.* 31 Am. St. Rep. 691; 51 N. W. Rep. 605; Lockwood *v.* Thunder Bay River Boom Co., 42 Mich. 536; Doyle *v.* Mizner, 42 Mich. 332; Deaderick *v.* Wilson, 8 Baxt. (Tenn.) 108; Kupfer *v.* South Parish, 12 Mass. 185. Thus, a trustee of an insurance company is not, unless specially charged by the board of trustees with the duty of communicating to a policy-holder its decision as to whether the company proposes to pay a loss, authorized to bind the company by his declaration in that regard. Cascade &c. Ins. Co. *v.* Journal Pub. Co., 1 Wash. 452; *s. c.* 25 Pac. Rep. 331.

[5] Allemong *v.* Simmons, 124 Ind. 199; *s. c.* 23 N. E. Rep. 768.

[6] Waite *v.* Windham County Mining Co., 36 Vt. 18.

contractor for the corporation and its agent for a particular purpose, is no evidence of their assent or the assent of the corporation to an arrangement then made in behalf of the corporation, by such agent, and exceeding his powers, with the contractor.[1]

§ 3907. But may be Agents by Special Appointment.—But this is entirely compatible with the conclusion that a single director may, with the knowledge of the board of directors, and independently of his duties as director, act *as agent* of the corporation, so that it will be bound by his acts in the course of the business conducted by him.[2]

§ 3908. Separate Assent of a Majority not Binding.—The next proposition is that a *separate assent of a majority* of the board, obtained when they are not regularly convened and acting together as a board, is not binding upon the corporation, in the absence of a subsequent ratification. When they are not consulting together as a board, they are regarded as acting privately and unofficially. It has hence been held that an agreement made by a *majority* of the directors of a corporation, among themselves, *privately and unofficially*, that that they should be paid a percentage upon all the money raised upon the credit of a bond of indemnity, signed by them, against the future indebtedness of said corporation, is not binding upon the corporation.[3] So, where, the prescribed quorum in a company being three, the secretary affixed the seal of the company to a bond, after having obtained the written authority of two directors at a private interview, and, at another private interview, the verbal promise of a third to sign the letter of authority, it was held that, as the seal was not affixed by the authority of the directors, meeting as a

[1] Barcus *v.* Hannibal &c. Plank Road Co., 26 Mo. 102.

[2] Goodwin *v.* Union Screw Co., 34 N. H. 378; Holmes *v.* Board of Trade, 81 Mo. 137, 142; National Security Bank *v.* Cushman, 121 Mass. 490. The last-named case presents a state of *evidence* on which it was held that a single director of a bank had power to discount a note.

[3] Butler *v.* Cornwall Iron Co., 22 Conn. 335.

board, the bond was therefore void.[1] So, the individual *declarations* of four of the five directors were held not to estop the corporation.[2]

§ **3909. Cannot Vote at Board Meetings by Proxy.** — It follows from the foregoing that a director cannot delegate his power to vote in the board of directors by giving a *proxy* to another person. But he must be present in person for the purpose of consultation; and for stronger reasons a proxy or power of attorney to vote at a stockholders' meeting will confer no authority to vote at a directors' meeting.[3]

§ **3910. Where the Act is Private, All must Join; where It is Public, a Majority may Act.** —The law makes this distinction in the execution of powers: That where the act which several persons are empowered to do is of a *private nature*,—as in the case of an ordinary *trust*,— all upon whom the power is conferred must join in executing it, unless the governing instrument otherwise provides. For instance, where the authority is *private, conferred upon two only*, nothing can be done without the consent of *both;* yet where the authority is *public*, to prevent a failure of justice or injury to the public, one may act without the other; as if one be dead, or interested, or absent.[4] Stating and explaining more fully, the ancient law is, that where several persons are authorized to do an act of a *public nature*, which requires *deliberation*, they should all be convened; because the advice and opinions of all may be useful, though all do not unite in the opinion; but though all must attend, a decision may be made by the voices of a majority. It is said by Lord Coke that a liberal construction should be given to powers concerning the administration of justice, which is *pro bono publico*. He instances the

[1] D'Arcy *v.* Tamar &c. R. Co., L. R. 2 Ex. 158; *s. c.* 2 Hurl. & Colt. 463; 36 L. J. (N. S.) 37; 14 Week. Rep. 96. See also Bosanquet *v.* Shortridge, 4 Ex. 699. Compare Collie's Claim, L. R. 12 Ex. 246; Re County Life Assurance Co., L. R. 5 Ch. 288.

[2] Cannon River Man. Asso. *v.* Rogers, 51 Minn. 388.

[3] Craig Medicine Co. *v.* Merchants' Bank, 59 Hun (N. Y.), 561; *s. c.* 36 N. Y. St. Rep. 923; 14 N. Y. Supp. 16.

[4] Downing *v.* Rugar, 21 Wend. (N. Y) 178; *s. c.* 34 Am. Dec. 223.

case of a sheriff, who gives a *warrant to three persons* jointly and severally to arrest another. The warrant may be *executed by two.*[1] This, however, is not an instance in point, because where a power is given to several persons jointly or severally, the only meaning of the term used must be that all may join in executing it, or that each one may execute it separately. So, to continue the illustration of Lord Coke, if a *venire facias* is awarded *to four coroners* to impanel and return a jury, and one die, the *survivors* may execute and return the same, though the reverse of this would be the rule in matters of a private nature.[2] It is *reasoned* that "in matters *purely ministerial,* there is no difficulty in procuring the concurrence of all, because there is nothing concerning which they can differ. But where the *judgment is to be exercised,* the inconvenience of requiring unanimity may be extreme." The learned judge who used this language recollected no public body in which unanimity was required except a petty jury.[3] It is therefore laid down that, in the exercise of a public as well as of a private authority, whether it be ministerial or judicial, all the persons to whom it is committed must *confer and act together,* unless there be a provision that a less number may proceed. Where the authority is *public,* and the number be such as to admit of a *majority,* such majority will bind the minority after all have duly met and conferred.[4]

§ 3911. Rule as to Public Acts Applicable to Private Corporations: A Majority of the Directors Rule. — This doctrine of the ancient law applicable to the execution of powers of a *public nature,* as contradistinguished from the execution of powers of a private nature, furnishes the rule which governs the directors of corporations either *public* or *private,* in the execution of their powers. The rule was no doubt first applied in the case of corporations at a time

[1] Co. Litt. 181 b.

[2] Case of Baltimore Turnpike, 5 Binn. (Pa.) 481, 485, opinion by Tilghman, C. J.

[3] *Ibid.*

[4] Downing *v.* Rugar, 21 Wend. (N. Y.) 178; *s. c.* 34 Am. Dec. 223; Moffitt *v.* Jaquins, 2 Pick. (Mass.) 331; Barrett *v.* Porter, 14 Mass. 143.

when nearly all corporations were of a *public* or *municipal* character, and, like many other rules, has found its way into the law of private corporations by an insensible adoption. As applied to private corporations, the rule is that a *majority of the directors are to rule,* — that is, that where the charter or other governing statute or instrument empowers the directors to do an act, a majority of them may do that act.[1] Thus, *four* of the *six* directors, who own in equal shares all the stock of a corporation formed for establishing a summer resort upon its land, may make a binding *dedication* of portions of such land to the public for *parks.*[2] So, in the absence of anything in the articles of association, or in the by-laws of a corporation, describing the number of directors who shall act, it is held that an *assessment* may be well made by a *majority* of the board.[3] But this is *always with the qualification*, previously stated and hereafter more fully explained, that a majority of the directors thus rule, provided they are *properly convened and acting together as a deliberative body*, or otherwise acting in accordance with their governing statute, regulation, or custom.[4] It is subject to the further qualification that this *majority*, when regularly assembled so as to constitute what is called a *quorum*, is regarded as a *unit*, and as being *all*, or the representative of all; so that a resolution adopted by a majority of this majority or *quorum*, is deemed to have been the act of a majority of all, although so many of the quorum may have dissented that a majority of the votes of all the directors are not recorded in favor of it; for, as none can dissent except those who are present,[5] the absent ones are deemed to assent.[6]

[1] Cram *v.* Bangor House, 12 Me. 354; Despatch Line *v.* Bellamy Man. Co., 12 N. H. 205; *s. c.* 37 Am. Dec. 203; Wells *v.* Rahway &c. Co., 19 N. J. Eq. 402; Booker *v.* Young, 12 Gratt. (Va.) 303.

[2] Attorney-General *v.* Abbott, 154 Mass. 323; *s. c.* 13 L. R. A. 251; 28 N. E. Rep. 346.

[3] St. Louis Colonization Asso. *v.* Hennessy, 11 Mo. App. 555, 560. Compare Edgerly *v.* Emerson, 23 N. H. 555; *s. c.* 55 Am. Dec. 207.

[4] *Ante*, § 726; *post*, §§ 3914, 3932.

[5] *Ante*, § 3909.

[6] See *post*, §§ 4111, 4357, 4360.

§ 3912. Distinction between a Select and Indefinite Body in Respect of a Quorum.— A distinction is also to be observed between a corporate act to be done by a *select body*, as the board of directors, and one to be performed by an *indefinite body*, as the constituent members of the corporate body. In the latter case a *majority* of those who assemble for a given purpose may act.[1] But in the former case the principles of the common law, in the absence of a different regulation established by statute, by-law, or usage, require a concurrence of the majority of all.[2] Thus, in the case of a *municipal corporation*, which is an *indefinite body*, an election is good, no matter how small a number of the electors go to the polls and vote, unless there is a statute providing differently.

§ 3913. Majority of All the Directors Necessary to a Quorum.— As the directors of a private corporation form a *definité body*, this statement points to the conclusion that a *majority of the directors of a corporation must be present* at any meeting, *to constitute a board* competent to transact business, unless the charter, articles of incorporation, or a valid by-law or usage, confers that power upon a less number.[3] Words in

[1] Ex parte Willocks, 7 Cow. (N.Y.) 402, 410; *s. c.* 17 Am. Dec. 525; Rex *v.* Varlo, Cowp. 248, 250; 5 Dane Abr. 150; *ante*, § 725.

[2] *Ante*, § 726.

[3] Ex parte Willocks, 7 Cow. (N. Y.) 402; *s. c.* 17 Am. Dec. 525; followed in People *v.* Walker, 2 Abb. Pr. (N. Y.) 425; *s. c.* 23 Barb. (N. Y.) 304, 308; Hax *v.* Davis Mill Co., 39 Mo. App. 453. That a majority constitutes a *quorum* in the absence of a statute or valid regulation providing otherwise, see St. Louis Colonization Asso. *v.* Hennessy, 11 Mo. App. 555; Edgerly *v.* Emerson, 23 N. H. 555; *s. c.* 55 Am. Dec. 207; Cram *v.* Bangor House, 12 Me. 354, 359. Therefore a special meeting of the directors of a bank having five directors, at which there are present but two directors and another person whose resignation as director has been accepted at a previous regular meeting of the board, was without authority to act as the board of directors. Wickersham *v.* Crittenden, 93 Cal. 17; *s. c.* 28 Pac. Rep. 788. A statute which declares that at all regular meetings of the directors, a majority of those present shall be competent to decide on all business, does not authorize a minority to act. A majority of all is necessary to constitute a regular meeting. Ex parte Willocks, 7 Cow. (N. Y.) 402; *s. c.* 17 Am. Dec. 525.

a statute, therefore, to the effect that a majority of the directors present at a regular meeting shall be competent to do business, cannot be construed as authorizing a minority of the board to act. This leaves the number competent for a quorum to be determined by the rules of the common law, which in no case of this kind is satisfied with less than a majority of the constituent number.[1]

§ 3914. But a Majority of the Assembled Quorum may Act. — But where this quorum is lawfully assembled, a majority of its members may act, unless the charter, statute, or other governing instrument prescribes differently.[2] When,

[1] 1 Kyd on Corp., 401, 411. There must be a select assembly of the distinct body authorized to act. If confused with other bodies at the meeting, the will of this heterogeneous assembly is no evidence of that of the one authorized body. Cammeyer *v.* United German Lutheran Churches, 2 Sandf. Ch. (N. Y.) 186; Leonard *v.* Lent, 43 Wis. 83; Methodist Episcopal Church *v.* Sherman, 36 Wis. 404.

[2] See cases first cited in the preceding section; also Rex *v.* Monday, Cowp. 530, 538; Rex *v.* Miller, 6 T. R. 268, 278; Rex *v.* Bellringer, 4 T. R. 810; Rex *v.* Whitaker, 9 Barn. & C. 648; Blacket *v.* Blizard, 9 Barn. & C. 851; Cook *v.* Loveland, 2 Bos. & P. 31; Rex *v.* Beeston, 3 T. R. 592; Withnell *v.* Garthan, 6 T. R. 388; Rex *v.* Bower, 1 Barn. & C. 492; Cortis *v.* Kent Water Works, 7 Barn. & C. 314; Grindley *v.* Barker, 1 Bos. & P. 229; Attorney-General *v.* Davy, 2 Atk. 212; Howbeach Coal Co. *v.* Teague, 5 Hurl. & N. 151; Ex parte Willocks, 7 Cow. (N. Y.) 402; *s. c.* 17 Am. Dec. 525; Cram *v.* Bangor House Proprietary, 12 Me. 354; Kupfer *v.* South Parish, 12 Mass. 189; Damon *v.* Granby, 2 Pick. (Mass.) 345; Hax *v.* Davis Mill Co., 39 Mo. App. 453; Foster *v.* Mullanphy Planing Mill Co., 92 Mo. 79; *s. c.* 4 S. W. Rep. 260; Despatch Line *v.* Bellamy Man. Co., 12 N. H. 205; *s. c.* 37 Am. Dec. 203; Edgerly *v.* Emerson, 23 N. H. 555; *s. c.* 55 Am. Dec. 207; Savings Bank *v.* Davis, 8 Conn. 191; Booker *v.* Young, 12 Gratt. (Va.) 303; Pejepscot Proprietors *v.* Cushman, 2 Me. 94; Trott *v.* Warren, 11 Me. 227; Adams *v.* Hill, 16 Me. 215; Keyser *v.* District, 35 N. H. 477; Buell *v.* Buckingham, 16 Iowa, 284; *s. c.* 85 Am. Dec. 516; Re Union Ins. Co., 22 Wend. (N. Y.) 591; Cahill *v.* Kalamazoo Ins. Co., 2 Dougl. (Mich.) 124; *s. c.* 43 Am. Dec. 457; Sargent *v.* Webster, 13 Met. (Mass.) 497; *s. c.* 46 Am. Dec. 743; Wells *v.* Rahway &c. Co., 19 N. J. Eq. 402; Wadhams *v.* Litchfield &c. Turnp. Co., 10 Conn. 416. Compare Van Hook *v.* Somerville Man. Co., 5 N. J. Eq. 137. Thus, where a power of election is vested in a definite number, certain persons being named as of that number, the presence only of such persons is necessary, and not their consent, provided there be a choice by the majority of the quorum. Cotton *v.* Davies, 1 Stra. 53. Otherwise, where an authority is confided to several persons for a private purpose, as a sub-

therefore, the *by-laws* of a private corporation have conferred upon the directors power to act in behalf of the corporation, without a special limitation as to the number who must concur, a majority may act within the scope of the powers given to the board, so as to bind the corporation, either where there is a consultation of all together and a concurrence of a majority, or where there is a regular meeting at which all might be present, and a majority actually meet and act by a major vote.[1] But it seems to be the *English law* that where the governing instrument prescribes the *minimum number* of directors by which the business of the company shall be conducted, the language is *mandatory*, and less than that minimum number cannot perform an act to which the concurrence of the directory is essential.[2]

§ 3915. Acts at Board Meeting without a Quorum Voidable. — The acts of directors done at meetings at which a quorum is not present are *void*, in the sense in which that word is most frequently used, — the meaning being that they are *voidable* at the election *of the corporation*, that is, of the directors in a legally constituted meeting, or by the *stockholders* in their constituent character, — subject, however, to

mission to certain persons named as *arbitrators*. Green *v.* Miller, 6 Johns. (N. Y.) 39; *s. c.* 5 Am. Dec. 184; Grindley *v.* Barker, 1 Bos. & P. 229; 236.

[1] Despatch Line *v.* Bellamy Man. Co., 12 N. H. 205; *s. c.* 37 Am. Dec. 203; Savings Bank *v.* Davis, 8 Conn. 191.

[2] Bottomley's case, 16 Ch. Div. 681. The articles of a company provided that "the business of the company shall be conducted by not less than" a specific number of directors, and it was held that a *forfeiture of shares* declared by a less number was invalid. Compare Thames-Haven Dock &c. Co. *v.* Rose, 4 Man. & G. 552; Kirk *v.* Bell, 16 Ad. & El. (N. S.) 290. Sir N. Lindley states the English rule to be that "if the affairs of a company are intrusted to the management of not less than a fixed number of directors, it is *prima facie* not bound by the acts of a fewer number." 1 Lind. Comp. Law (5th ed.), 155; citing Card *v.* Carr, 1 C. B. (N. S.) 197; Ex parte Howard, L. R. 1 Ch. 561; Kirk *v.* Bell, 16 Ad. & El. (N. S.) 290; Brown *v.* Andrew, 13 Jur. 938; Ridley *v.* Plymouth &c. Grinding Co., 2 Ex. 711; Holt's case, 22 Beav. 48; Nicol's case, 3 De Gex & J. 387; Ex parte Credit Foncier, L. R. 7 Ch. 161; Moody *v.* London &c. R. Co., 1 Best & S. 290; Ex parte Birmingham Banking Co., L. R. 3 Ch. 651.

the exception that certain acts, not of a *discretionary* or *legislative* character, may be delegated[1] to a smaller number than a quorum of the whole board, and including the idea that such acts may be made good by a *ratification*, the same as other voidable corporate acts which are within the powers of the corporation.[2] For instance, where the charter of a company required five directors to constitute a quorum, and there were but four present when a resolution was passed authorizing the execution of a mortgage, the mortgage was held null and void, from the fact that it never received the sanction of the board of directors.[3] Even if it is admitted that the directors may bind the corporation where they *act separately*,[4] yet the consent of several members of a board of directors, acting separately, and *not shown to constitute a quorum*, will not constitute a valid acceptance of a proposal made to the company, so as to render it a complete contract, and binding upon the party making the offer.[5] Nor can a contract made by the board be changed by less than a quorum of the board.[6]

§ 3916. Must be a Quorum of Each Integral Part.— Where a corporation consists of *several definite integral parts*, there must be a majority of each such integral part present, in order to constitute a corporate assembly of the whole.[7] In a case of this kind Lord Ellenborough said: "It is the same

[1] *Post*, § 3944, *et seq.*

[2] *Post*, § 5314.

[3] Coryell *v.* New Hope &c. Co., 9 N. J. Eq. 457; Ex parte Morrison, 11 Jur. 719.

[4] *Post*, § 3938.

[5] Junction R. Co. *v.* Reeve, 15 Ind. 236.

[6] Tennessee &c. R. Co. *v.* East Alabama R. Co., 73 Ala. 426.

[7] Rex *v.* Bellinger, 4 T. R. 810, 823; Rex *v.* Miller, 6 T. R. 268, 278; Rex *v.* Thornton, 4 East, 294, 307; Rex *v.* Buller, 8 East, 389; Rex *v.* Devonshire, 1 Barn. & C. 609, 614; Re St. Mary's Church, 7 Serg. & R. (Pa.) 517; Ex parte Rogers, 7 Cow. (N. Y.) 526, and note. Later American cases do not, however, adhere so strictly to the English rule. See Ex parte Humphrey, 10 Wend. (N. Y.) 612; People *v.* Whiteside, 23 Wend. 9, *s. c.* reversed, 26 Wend. (N. Y.) 634; Beck *v.* Hanscom, 29 N. H. 213. In Wardens of Christ's Church *v.* Pope, 8 Gray (Mass.), 140, the *vestry* of a religious society was held entitled to transact business in the absence of both wardens, a majority of all their members being present, although it had been voted at several annual meetings that one warden and four vestrymen constitute a quorum for the transaction of business.

as if an election were ordered to be made by three distinct corporations, in which case a majority of each corporation must meet in order to constitute an elective assembly."[1]

§ 3917. **Rule in Case of Unfilled Vacancies.** — It is even held that a good elective assembly cannot be had without the presence of such a number of persons as will constitute a majority of the entire definite number, although the number present may constitute a majority of so many of the entire number as may happen at the time to be *surviving and existing*;[2] otherwise, by suffering without supplying diminutions of their number happening through death, resignation, or otherwise, the essential constitution of the body might be changed.[3]

§ 3918. **In the Case of a Special Committee a Majority of All must Concur.** — There is a mass of judicial authority to the effect that where the power to make a contract is vested in a *committee* of a municipal, religious, eleemosynary, or other corporation, a *majority* of the committee must execute the contract, or it will not be binding upon the corporation. In such a case the law does not permit a *second delegation* of authority[4]

§ 3919. **Effect of the Disqualification of a Member of the Quorum.** — The natural conclusion would be that if for any reason, one whose vote is necessary to a resolution of a board of directors or trustees is disqualified from sitting and voting, the resolution will be deemed not to have been passed. This, we shall see, is the law in respect of the passage of

[1] Rex *v.* Morris, 4 East, 17, 27. The most usual illustration of the principle will be found in the *common council* of a municipal corporation, where there must be a majority of a quorum of *each house* to pass an ordinance.

[2] Rex *v.* Devonshire, 1 Barn. & C. 609, and cases cited to previous section.

[3] Reasoning of Abbott, C. J., in the case last cited, at p. 615.

[4] Curtis *v.* Portland, 59 Me. 483; Female Orphan Asylum *v.* Johnson, 43 Me. 180; Hanson *v.* Dexter, 36 Me. 516; Adams *v.* Hill, 16 Me. 215; Howard *v.* Marine Indus. School, 78 Me. 230; Kupfer *v.* Augusta, 12 Mass. 185; Damon *v.* Granby, 2 Pick. (Mass.) 345, 352.

resolutions in which some of the directors are directly and personally interested, such as resolutions concerning their own *salaries*.[1] But it does not follow from this that, in the absence of a statute so providing, what would disqualify a *judge* of one of the ordinary judicial courts from sitting in a given case, will disqualify a director or trustee of a corporation. An analogy has been rather sought in the case of *ministerial public officers*. Thus, where a certain prescribed majority of the governing committee of a *social club* have power to *expel* a member, the fact that one member of this majority, who voted for the expulsion, is *related* to the member of the committee or club who has moved for the expulsion, does not, it has been held, render the resolution of expulsion invalid.[2] So, where, under the charter of a city, *alienage* was a disqualification for membership in the board of aldermen, yet the fact that the vote of an alien member was necessary to the passage of an ordinance did not render it void; since, while sitting and voting unchallenged, he was a *de facto* member.[3]

§ 3920. What is a Quorum where the Directory has been Enlarged by a Consolidation with Another Corporation. — An original charter granted by the State of Connecticut

[1] *Post*, § 4381.

[2] Loubat *v.* Leroy, 15 Abb. N. C. (N. Y.) 14; *ante*, § 893. That a *judge* is bound to sit notwithstanding a near relative is a party, if the statute law makes no provision for substituting another judge, see Re Leefe, 2 Barb. Ch. (N. Y.) 39. Case in which Chancellor Kent was obliged to sit although his brother was a party: Mooers *v.* White, 6 Johns. Ch. (N. Y.) 360. That an objection on this ground may be *waived*, and that a party is deemed to *acquiesce* who does not reasonably object, see Page *v.* Fazackerly, 36 Barb. (N. Y.) 392. That a court required to consist of *eight* judges may act by *seven*, if one is incompetent by reason of consanguinity, see Oakley *v.* Aspinwall, 3 N. Y. 547. And decide with the concurrence of only *four: Ibid.* That a constitutional amendment required to be proposed to the people by "two-thirds of each house" of the Legislature is well proposed by a *quorum of two-thirds of each house*, — see State *v.* McBride, 4 Mo. 303; *s. c.* 29 Am. Dec. 636; Green *v.* Weller, 32 Miss. 650, 677. That an act of incorporation requiring the "assent of at least two-thirds of each house" is well passed by *two-thirds of a quorum* of each house, — see Southworth *v.* Palmyra &c. R. Co., 2 Mich. 287.

[3] Satterlee *v.* San Francisco, 23 Cal. 314.

required four directors to constitute a quorum. The company was afterwards *merged* with a corporation chartered by Rhode Island, whose charter was silent as to the number required. By the contract of merger, which was affirmed by the Rhode Island Legislature, the latter company surrendered its franchises, powers, and privileges to the Connecticut company; and the Connecticut Legislature, by an act confirming the merger, declared that all the rights of the old company in this State should be preserved to the new one. It was held that, after the merger, *four only*, and *not a majority*, were necessary for a quorum.[1]

§ 3921. By-law Fixing Quorum at Less than a Majority. It has been held that a by-law is valid which provides that a quorum of the directors may consist of a less number than a majority. A charter declared that the corporate powers should be exercised by a board of *twenty-three directors*. It omitted to prescribe the number necessary for a quorum, but gave power to make such by-laws as the board should judge necessary. It was held (1) that a by-law declaring five directors — or, in the absence of the president, seven — a quorum for the transaction of the ordinary business of the company was valid; (2) that an assignment of securities to a very large amount, made under the corporate seal, to secure to the assignee an admitted debt arising in the business of the company, was "ordinary business of the company," which such quorum might direct. In the view of the court, the fact of the transaction being small or large, could not affect the question whether it was "ordinary business." Though such pledge or assignment was of the principal part of the assets of the corporation, to a creditor who was pressing for payment of a very large demand, yet, as it was not made with the design of going into insolvency, but to relieve the corporation from embarrassment and enable it to continue its business, — the transaction should be deemed included in the authority delegated to the five directors:[2] a doubtful holding indeed.

[1] Lane *v.* Brainerd, 30 Conn. 565.

[2] Hoyt *v.* Thompson, 5 N. Y. 320.

§ 3922. Whether Ex Officio Trustees not a Part of the Quorum. — There is a holding in New York to the effect that *ex officio* trustees are not necessarily a part of the quorum. Three societies were authorized by statute to choose three trustees each, to take and hold real estate, and erect a hall thereon for the use of the three; and the statute also provided for two *ex officio* trustees, making eleven in all; and declared that it should be lawful for the board of trustees, or a majority of them, to mortgage the land. It was held that a mortgage executed by five of the nine chosen trustees might be presumed to have been executed with the concurrence of a majority of the board.[1] This holding does not seem to be sound. *Ex officio* trustees are either trustees or they are not trustees. If they are trustees, it makes no difference *how* they happen to be such; they possess the powers and the rights of other trustees, and are hence necessary to make up a majority which alone can bind the corporation in extraordinary matters. Where a statute authorized an agricultural society, by vote of five of its directors, to sell and dispose of its property and invest the proceeds, and the board of directors consisted of the president, the secretary, the treasurer, and five directors, the officials named being directors *ex officio*, and at the meeting of the board convened to act under the statute there were present the president, the secretary, and four directors, all of whom voted to sell the property,—it was held that the sale was valid, since the *ex officio* directors were as much entitled to vote as those specifically called directors.[2]

§ 3923. Number that may Act in Ministerial Matters. — In ministerial matters, such as may be *delegated* under principles elsewhere discussed,[3] a *majority* may act, so as to bind the rest; or even a less number may act by *delegation* or *appointment*. Applying this principle, it has been held that where an *unincorporated company* was organized and three

[1] Miller *v.* Chance, 3 Edw. Ch. (N. Y.) 399.

[2] Kent County Agric. Soc. *v.* Houseman, 81 Mich. 609; *s. c.* 46 N. W. Rep. 15.

[3] *Post*, § 3947.

persons were appointed as managers for the first year, with authority to commence business when sufficient capital should be subscribed, paid in or secured, and *two of these managers* incurred an indebtedness for materials with which to commence business, all the members were bound to pay this indebtedness *as partners.* The court laid stress on the fact that it did not appear that the two *had not* acted with the *consent of the third,*[1] and that it was not necessary that the third should be corporeally present.[2] There is an English holding to the effect that where directors of a company, acting within their authority, resolve that all the powers of the directors, other than to make calls, be delegated to three of the directors as a committee, but the resolution does not appoint a quorum, although unanimity of the committee might not be necessary to make their acts valid, they must all be present at a meeting; and they have no power to appoint other members of the committee, either in addition to, or to fill a vacancy in, the committee.[3]

§ 3924. Acts of Directory Composed of Excessive Number. The action of the directory of a corporate body composed of a greater number than allowed by the charter, is none the less valid and binding, if the stockholders do not complain, but acquiesce.[4]

§ 3925. Directors No Power to Exclude Some of their Board. — From what has preceded, it must follow that the stockholders are entitled to have the business of the corporation controlled by the whole board which they have lawfully elected; and hence it is not competent for a majority of the board to exclude a minority, or even a single member;[5] and it would seem equally to follow that, after such an unlaw-

[1] As to the presumption of such consent, see *post,* §§ 3926, 3927, 4357.

[2] Wells *v.* Gates, 18 Barb. (N. Y.) 554, 558.

[3] Re Liverpool Household Stores Asso., 8 Rail. Corp. L. J. 227; *s. c.* 62 L. T. (N. S.) 873; 59 L. J. Chan. 616.

[4] Hax *v.* Davis Mill Co., 39 Mo. App. 453.

[5] State *v.* Ohio &c. R. Co., 6 Ohio C. C. 414.

ful exclusion, there is no board remaining which is competent to act so as to bind the corporation, in the absence of circumstances of estoppel.

§ **3926. Presumption in Favor of Regular Action.** — A general presumption of validity attends the acts of corporate directors at the outset, where nothing to the contrary appears; and it has been said that "when the act purports to be the act of the board, it may be *presumed* that it was the act of the majority until the contrary is shown."[1] But where the facts are disclosed, and they show nothing more than an assent by the directors separately and without consultation, then the conclusion ought to be that the act does not bind the corporation, unless *something further* is disclosed, as, for instance, a *custom* of acting that way, or a ratification.[2] What is *evidence of assent* where the particular member is present at a meeting of the board, is elsewhere considered.[3] If a director be present at the adoption of a resolution and aware of what is being done, and makes no opposition to its adoption, he must be *presumed* to have assented to it. But if such proceeding be merely *preliminary* to a decision by a subsequent vote of the stockholders, on a question so important as the *consolidation* of the corporation with another corporation, which can only be ultimately decided by the vote of all the stockholders, and not of the board of directors, such consent, so given by a member of the board of directors, who is also a stockholder, does not *estop* him from afterwards objecting to the consolidation.[4]

§ **3927. Extent of This Presumption.** — This presumption includes the presumption that the *meeting* of a board of direct-

[1] Despatch Line *v.* Bellamy Man. Co., 12 N. H. 205; *s. c.* 37 Am. Dec. 203, *per* Parker, C. J. It has been held *competent evidence*, that is sufficient presumptive proof, *for a stranger*, of the concurrence of a quorum of a board of directors of a corporation, to show that they *assented separately*. Tenney *v.* East Warren Lumber Co., 43 N. H. 343.

[2] *Ante*, § 3908; with which compare *post*, § 3938.

[3] *Post*, § 4357, *et seq.*

[4] Mowrey *v.* Indianapolis &c. R. Co., 4 Biss. (U. S.) 78.

ors at which a given resolution was passed was regularly convened.[1] Thus, where the validity of an act done at a special meeting of the board of directors of a corporation is drawn in question, on the ground that some of the directors were not notified to attend the meeting, the burden is on the party attacking the regularity of the proceedings to show that the directors in question were not in fact notified. If it appear that a meeting was held, and that a *quorum* was present, it will be presumed, in the absence of evidence to the contrary, that due notice was given, and that all steps necessary to constitute it a regular and valid meeting were taken.[2] This is especially so where the minutes of the corporation recite that *notice* had been given, but do not state in what *manner* it was given.[3] So, where an officer of a corporation is required to be chosen by *ballot*, and the record of his election does not specify the mode, the legal presumption is that he was chosen by ballot.[4] So, where *unanimity* is necessary to the legal authority to make an order on the books of the corporation, and such order was entered of record, it should be presumed to have been made with the unanimity required, although that fact does not appear in the record.[5] Where the charter of a corporation required that *two-thirds* should be assembled for the transaction of business, and it appeared from the minutes that "after due invitation, the corporators met"—it was held that this was sufficient to prove a meeting of two-thirds, as the custom had not been to mention the names or number of those present.[6] So, where the by-laws of a corporation required the meetings to be held *at the counting-room* of the corporation, and it appeared from the records that a meeting was held at the dwelling-house of the general agent

[1] Sargent *v.* Webster, 13 Met. (Mass.) 497; *s. c.* 46 Am. Dec. 743; Chouteau Ins. Co. *v.* Holmes, 68 Mo. 601; *s. c.* 30 Am. Rep. 807.

[2] *Post*, §§ 3935, 5029.

[3] Granger *v.* Original Empire &c. Co., 59 Cal. 678; *s. c.* 9 Am. Corp. Cas. 27. Compare Harding *v.* Vandewater, 40 Cal. 78.

[4] Blanchard *v.* Dow, 32 Me. 557.

[5] Lexington *v.* Headley, 5 Bush (Ky.), 508.

[6] Commonwealth *v.* Woelper, 3 Serg. & R. (Pa.) 29; *s. c.* 8 Am. Dec. 628.

and clerk, without stating that it was at the counting-room of the corporation, and there was no other evidence in reference thereto, — it was held that the court would presume that their counting-room was, for the time being, at that place.[1] Where an act of incorporation directed in what manner the first meeting of the corporation should be called, and it was shown that at the first meeting the proper officers were elected in due form, and no defects were shown in the subsequent proceedings of the corporation for twenty years or more, — it was held that there was sufficient presumptive proof of its original organization, although it did not appear how the first meeting was called.[2] So, if the clerk of a corporation is present when a vote approving his election is passed, and he himself records the vote, his *acceptance* of the office will be presumed.[3]

§ 3928. Ratification of Acts Done by Less than the Requisite Number. — The act of less than a quorum may be *ratified by the quorum* and thus become binding upon the corporation. Thus, at two meetings of an insurance company, losses were allowed by directors, there being no quorum present at either meeting. It was held that "the vote of a quorum to assess their members to pay these losses, or to pay the debts incurred to meet them, was a distinct, unequivocal evidence of ratification of their allowance and payment."[4] The rule is said to be settled that where, at a meeting of a board of directors of a corporation formed for purposes of pecuniary profit, an act is ordered to be done, without objection, either then or subsequently made, to the regularity of the meeting by any director or stockholder, and the act thus authorized is afterward *performed*, its legality cannot afterward be questioned in a suit in equity on the ground of irregularity.[5]

[1] McDaniels *v.* Flower Brook Man. Co., 22 Vt. 274.

[2] Society of Middlesex Husbandmen &c. *v.* Davis, 3 Met. (Mass.) 133.

[3] Delano *v.* Smith Charities, 138 Mass. 63.

[4] Atlantic &c. Ins. Co. *v.* Sanders, 36 N. H. 252, 270; Hanson *v.* Dexter, 36 Me. 516. *Contra*, Price *v.* Grand Rapids &c. R. Co., 13 Ind. 58.

[5] Samuel *v.* Holladay, 1 Woolw. (U. S.) 400.

Upon a principle already suggested,[1] where two agents are appointed by a *parish* to make an entry on land, an entry by one alone does not pursue the authority; but the parish may avail themselves of such entry by *bringing their action* upon it, which will be a ratification.[2] Where there is a *power to act*, but the action is *irregularly done*, unquestionably the same body may cure the defect by subsequent action. But where there is *no power to act*, the body which has assumed to act without power cannot *ratify*.[3] If this distinction is kept in mind, the propriety of a decision will be seen, where it was held that where a board of directors had passed a resolution for the payment of a salary to one of their members, to which resolution his own vote was necessary, whereby the resolution was not in fact adopted, it did not become adopted by the *approval*, at a subsequent meeting, *of the minutes* of the meeting at which the resolution was thus attempted to be passed.[4] The approval of the minutes at the subsequent meeting was simply an assertion by the directors that the secretary had properly recorded them.[5] Doubtless the subsequent passage of a resolution to which the vote of the beneficiary director was not necessary, would have cured the previous defect.

§ 3929. Power of a Quorum to Contract with their Own Members.—It is perfectly clear from the foregoing premises that where a bare quorum is assembled, no contract can be made with a member of that quorum, because such a contract requires his concurrence, and he cannot be on both sides of the same contract. As to *that* contract he is not a *director*, but is a *stranger;* and when he steps out of the bare quorum and assumes the attitude of a stranger, the quorum is broken.[6] In one case involving this question,[7] the act incorporating the company did not specify what number of directors should con-

[1] *Ante*, §§ 726, 3911.

[2] First Parish *v.* Cole, 3 Pick. (Mass.) 232.

[3] *Post*, § 5287.

[4] Davis Mill Co. *v.* Bennett, 39 Mo. App. 460.

[5] *Ibid.*

[6] See, upon this subject, Miner *v.* Belle Isle Ice Co., 93 Mich. 97.

[7] Van Hook *v.* Somerville Man. Co , 5 N. J. Eq. 137.

stitute a quorum, but that a board of five should have the management of the stock, property, and concerns of the company, one of whom was to be president. By other provisions the president and directors, or a majority, had power to act in specified cases, such as calling in stock, appointment of agents, etc. The president and two of the directors met and made a mortgage of the company's property to one of the latter. Chancellor Halsted refused to recognize this action as valid, on the ground that a member of a corporation contracting with it is regarded, as to that contract, as a stranger. But where the board of directors of a corporation consisted of *eleven*, all of whom convened at a meeting of the board, and at such meeting the board adopted a resolution under which a deed of trust of its assets was executed, which deed secured and preferred *four* of its directors who were its creditors and who were present and voted for the resolution, and *six* disinterested directors voted for it and one voted against it, it was held a valid act of the corporation; since seven of the directors constituted a quorum, and the resolution was carried not only by a majority of the quorum, but by a majority of those present who were disinterested.[1] A similar conclusion has been reached in other cases. In a case before the Supreme Court of Iowa,[2] the by-laws provided that the president and two directors should constitute a quorum. At a meeting at which the president and two directors only were present, a sale of the property of the corporation was made to the president. The transaction being free from the taint of fraud, the validity of this sale was confirmed. One of the judges reasoned thus: "Since the president and two of the directors constituted a quorum, it was competent for two, being a majority of that quorum, to bind the corporation; and if two were able to act, even as against the opposing vote of the other, they could, *a fortiori*, act without his concurrence."[3] This reasoning, of course, assumes that a person incapacitated to act (because a

[1] Foster *v.* Mullanphy Planing Mill Co., 92 Mo. 79, 88.

[2] Buell *v.* Buckingham, 16 Iowa, 284; *s. c.* 85 Am. Dec. 516.

[3] *Per* Cole, J., *Ibid.*, p. 288. See also St. Louis *v.* Alexander, 23 Mo. 483, 489.

director is the corporation's trustee) may yet constitute an essential factor in the quorum for action. It is perfectly clear that a member of a corporation is not incapacitated by such a circumstance from dealing with the corporate body;[1] it is equally plain that a member of a bare quorum ceases to be such the moment that the subject of his own contract with the corporation is taken up. Such contracts, always so fragrant with suspicion, ought at least, on the side of the corporation, to be concurred in by a majority of the whole board.

§ 3930. **Place of the President in the Quorum.**—It is not necessary that the *president* of a corporation should be present at the meeting of the board of directors at which a vote authorizing the doing of a corporate act is passed. "The president and directors" is said to be a convenient and very common mode of designating the board of directors in their aggregate capacity; but it does not render the presence of the president essential, unless otherwise required by the charter or by-laws.[2] But the president, being almost always, and under most systems necessarily, a director, *counts*, in making up the quorum, *as a director*. Thus, where the charter of a bank required seven directors to make a board, and declared the president to be entitled to all the powers and privileges of a director, the president and six directors were held to constitute a sufficient board to satisfy the requisitions of the charter.[3] So, where there were *five* trustees, of whom the president was one, a report signed by the *president and two trustees* was held to comply with a statute[4] requiring it to be "signed by the president and a majority of the trustees."[5]

§ 3931. **When Take the Sense of the Stockholders.**—In *joint-stock corporations* the directors cannot perform what are

[1] 1 Kyd on Corp. 180; Ang. & Ames on Corp., § 233; Worcester Turnp. Co. *v.* Willard, 5 Mass. 80; *s. c.* 4 Am. Dec. 39; Gilmore *v.* Pope, 5 Mass. 491; Berks &c. Turnp. Road *v.* Myers, 6 Serg. & R. (Pa.) 12; *s. c.* 9 Am. Dec. 402; Gordon *v.* Preston, 1 Watts (Pa.), 385; *s. c.* 26 Am. Dec. 75, *per* Gibson, C. J.

[2] Sargent *v.* Webster, 13 Met. (Mass.) 497; *s. c.* 46 Am. Dec. 743.

[3] Bank of Maryland *v.* Ruff, 7 Gill & J. (Md.) 448.

[4] N. Y. Laws 1848, ch. 40, § 12.

[5] Glen's Falls Paper Co. *v.* White, 18 Hun (N. Y.), 214.

called *constituent acts* without convening the stockholders,—as, for instance, *increasing or diminishing* the capital stock,[1] or otherwise essentially changing the purpose for which the corporation was formed, or putting an end to its existence or operations. So, it has been held that a *majority* of the board of directors of a passenger railway company, though controlling a majority of the stock, have no power, without special authority in their charter, to *execute a lease* of the road and property without first submitting the question to the stockholders at a meeting called in accordance with their charter.[2] But, as we have already seen,[3] there are cases where the *trustees*, and not the body of members, *are the corporation*,—that is to say, the body which has been incorporated. In such a case the members cannot perform any corporate act, though no reason is perceived why the trustees may not assemble them for the purpose of taking their *advice* as to any proposed line of action. Thus, it has been held that a resolution passed at a general meeting of a religious *corporation*, though a majority of the trustees are present and concur, is not a corporate act.[4]

§ 3932. Majority can Act only at a Regular Meeting.—The cases which hold that, a majority of a definite body being assembled, a majority of those assembled may act,[5] imply that *the quorum is regularly assembled*, either in regular or *stated meeting*, or else upon due *notice*.[6] In general, the mere accidental assembly of a majority of persons who are directors of a company does not constitute a legal board;[7] and the acts of

[1] *Ante*, §§ 86, 956, 2076.

[2] Martin *v.* Continental Pass. R. Co., 14 Phila. (Pa.) 10.

[3] *Ante*, § 16.

[4] Cammeyer *v.* United German Lutheran Churches, 2 Sandf. Ch. (N. Y.) 186.

[5] *Ante*, § 3914.

[6] Despatch Line *v.* Bellamy Man. Co., 12 N. H. 205; *s. c.* 37 Am. Dec. 203, 207. Compare Edgerly *v.* Emerson, 23 N. H. 555; *s.c.* 55 Am. Dec. 207.

[7] Hoyt *v.* Bridgewater Copper M. Co., 6 N. J. Eq. 253, 275; Hillyer *v.* Overman S. M. Co., 6 Nev. 51; Cammeyer *v.* United German Lutheran Churches, 2 Sandf. Ch. (N. Y.) 186, 229. *Contra*, State *v.* Smith, 48 Vt. 266; Waite *v.* Windham Mining Co., 37 Vt. 608; Bank *v.* Rutland &c. R. Co., 30 Vt. 159; Barcus *v.* Hannibal &c. R. Co., 26 Mo. 102.

directors, at a meeting irregularly called, as where *notice* of the meeting is not given to some of the directors,—is not binding on the corporation unless ratified.[1] The settled law is said to be "that in case of a definite body, like a board of bank directors, a majority must be present *at a regular meeting*, or at a special meeting notified according to by-law, if there be any, or otherwise reasonably notified to all the members (excepting perhaps, cases of absence at a distance) without fraud or attempt at surprise; and at such meeting a majority of those present can act for the whole."[2] When, therefore, a corporate by-law declared that "a *majority vote* of the directors shall at all times determine the action of that body," it was held that this meant a *majority of a quorum* present at a meeting of the directors, within the meaning of the above rule.[3] So, where the validity of a *mortgage* was called in question, and it did not appear that it had been assented to by all the directors at any meeting, or even separately; that there had been no meeting and consultation of the whole board at which a *vote* of the majority authorized the mortgage to be executed; nor that there had been any meeting regularly notified or held at some regular period at which, though all did not appear, a majority assembled and assented to the making of the mortgage by a majority vote; but, on the contrary, that the assent was given by two of the directors only, and that there was nothing to show that the third had an opportunity to act,—it was held that the mortgage was void.[4]

§ **3933. Meet outside the State.**—Whether the corporators at large can hold a meeting, for the purpose of organizing or doing any other *constituent* act outside the State,[5] it is gener-

[1] Gordon *v.* Preston, 1 Watts (Pa.), 385; *s. c.* 26 Am. Dec. 75; Stow *v.* Wyse, 7 Conn. 214; *s. c.* 18 Am. Dec. 99.

[2] Lockwood *v.* Mechanics' Nat. Bank, 9 R. I. 308; *s. c.* 11 Am. Rep. 253, 266. See also Sargent *v.* Webster, 13 Met. (Mass.) 497; *s. c.* 46 Am. Dec. 743; Cahill *v.* Kalamazoo Ins. Co., 2 Dougl. (Mich.) 124; *s. c.* 43 Am. Dec. 457.

[3] Foster *v.* Mullanphy Planing Mill Co., 92 Mo. 79, 89.

[4] Despatch Line *v.* Bellamy Man. Co., 12 N. H. 205; *s. c.* 37 Am. Dec. 203.

[5] *Ante*, § 694.

ally agreed that the directors, being but officers or agents, can hold meetings outside the State for the transaction of the ordinary business of the corporation,[1]—as for instance, to appoint a secretary;[2] or confer power upon an agent to execute a deed;[3] and their minutes may be used as evidence of their acts, even though their meetings appear to have been held out of the chartering State.[4] And even if they have no such power, it seems a sound conclusion that a stockholder will not be heard to raise the objection, if he has attended previous meetings at the same place without ever having objected to their being held at such place.[5]

§ 3934. When Record Need not Affirmatively Show Notice. *When a quorum are present* at a meeting of directors, the presumption is that proper notice was sent to all;[6] and one court has taken the unjustifiable position that where a *quorum* of the directors of a bank meet, and unite in any determination, the corporation is bound, whether the other directors are, or are not, notified.[7] A rule of this kind opens the door wide to secret cabals and "ring" management among the directors. The other rule, elsewhere expressed,[8] is, that every member has the right to be present for consultation, and to watch the proceedings, although he may be in the minority, and that where this right is ignored, the proceedings, unless made good by other principles, are void. It is not necessary, where the validity of a corporate act is drawn in question, that it should appear from the records of the corporation that notice was given to all the directors of the meeting of the board at which the act was authorized; since, as elsewhere stated,[9] a corporation is not, like a court of justice, a body that can only speak by its record. On the contrary, it is

[1] Ohio &c. R. Co. *v.* McPherson, 35 Mo. 13; *s. c.* 86 Am. Dec. 128.

[2] McCall *v.* Byram Man. Co., 6 Conn. 428.

[3] Arms *v.* Conant, 36 Vt. 744.

[4] Wood Hydraulic &c. Co. *v.* King, 45 Ga. 34.

[5] Wood *v.* Boney (N. J.), 21 Atl. Rep. 574.

[6] Wells *v.* Rodgers, 60 Mich. 525; *s. c.* 27 N. W. Rep. 671.

[7] Edgerly *v.* Emerson, 23 N. H. 555; *s. c.* 55 Am. Dec. 207.

[8] *Ante*, § 708.

[9] *Post*, § 5174, *et seq.*

sufficient if the fact that there was no notice does *not appear.* "It would be hazardous," said the Massachusetts court, in an opinion written by Shaw, C. J., "to decide that every vote passed by an aggregate body is void if it do not appear by the record that all were notified. We believe it is not usual, in corporate records, to state how the members were notified. The presumption *omnia rite acta* covers multitudes of defects in such cases, and throws the burden upon those who would deny the regularity of a meeting for want of due notice, to establish it by proof." [1]

§ 3935. Manner of Assembling the Meeting. — Keeping in view the principle that no valid corporate act can be taken by the board of directors at a *special meeting*, unless it has been *duly assembled*,[2] it follows that where a statute, by-law, or other governing instrument, directs the mode of assembling a special meeting, any corporate action taken at a meeting not so assembled will be voidable, in the absence of unanimous consent. For instance, if the governing statute provides that the meeting shall be called by the president, if there be one, and if not, by two directors, then if there is a president, two directors cannot call a meeting, especially without conferring with the president, and notifying him of the objects and purpose of the meeting.[3] Nor will the refusal of the president to make the call take such a case out of the rule, at least unless an abuse of discretion is shown.[4]

§ 3936. When Notice of the Meeting must be Given. — The circumstances under which notice of corporate meetings must be given in order that the action taken thereat should be

[1] Sargent *v.* Webster, 13 Met. (Mass.) 497; *s. c.* 46 Am. Dec. 743. To the same effect, see Chase *v.* Tuttle, 55 Conn. 455; *s. c.* 3 Am. St. Rep. 64; 12 Atl. Rep. 874.

[2] *Ante*, § 706; Thompson *v.* Williams, 76 Cal. 153; *s. c.* 9 Am. St. Rep. 187; 18 Pac. Rep. 153; San Buenaventura &c. Co. *v.* Vassault, 50 Cal. 534 (general meeting); Reilly *v.* Oglebay, 25 W. Va. 36; Smith *v.* Dorn, 96 Cal. 73; *s. c.* 30 Pac. Rep. 1024.

[3] Smith *v.* Dorn, 96 Cal. 73; *s. c.* 30 Pac. Rep. 1024.

[4] *Ibid.*

valid, have been already considered,[1] with the conclusion that where the meeting is a *stated* one,[2] the time and place of which is fixed by some by-law or regulation, no notice of it is necessary, but that where it is a *special* or *called* meeting, all the members must be notified of it. But while all the members must be notified, the principles already explained,[3] imply that it is not necessary that they should all be present, in order to bind the corporation by their action.[4] It has been held that where the manner of giving notice is prescribed by the *by-laws*, and these *by-laws* are established *by the directors*, but not by the corporation, it is competent for the directors to *disregard* such a by-law, so far as third persons dealing with the corporation are concerned; so that if they do disregard a by-law directing what notice shall be given of a special meeting, the corporation cannot set up the irregularity in order to impair, as towards third persons, the directors' acts.[5] Where a meeting of a board of directors of a bank in New Haven was called by the cashier, in pursuance of instructions from the president, then in New York, by personal notice to the directors in New Haven, *without specifying*, in such notice, *the object* of the meeting, it was held that this was a legal meeting for *ordinary transactions;* and that the giving of security for a debt of the bank, by a mortgage of its real estate, was of this description.[6] In the absence of a statute, by-law, or other governing instrument prescribing the manner in which notice shall be given, *personal* notice is necessary, and it will not be sufficient to leave a copy of a written notice at

[1] *Ante*, § 707, *et seq.*; State *v.* Bonnell, 35 Ohio St. 10; People *v.* Batchelor, 22 N. Y. 128; Merritt *v.* Farriss, 22 Ill. 303; Warner *v.* Mower, 11 Vt. 385.

[2] In some States notice of *stated* or *annual* meetings is required: San Buenaventura &c. Co. *v.* Vassault, 50 Cal. 534.

[3] *Ante*, § 708. And see 3 Am. St. Rep. 69, note, and the following cases there cited: Pike Co. *v.* Rowland, 94 Pa. St. 238; Kersey Oil Co. *v.* Oil Creek &c. R. Co., 12 Phila. (Pa.) 374; Doyle *v.* Mizner, 42 Mich. 332; Harding *v.* Vandewater, 40 Cal. 77; Farwell *v.* Houghton Copper Works, 8 Fed. Rep. 66; State *v.* Ferguson, 31 N. J. L. 107, 124; D'Arcy *v.* Tamar &c. R. Co., L. R. 2 Ex. 158.

[4] Story *v.* Furman, 25 N. Y. 214.

[5] Samuel *v.* Holladay, 1 Woolw. (U. S.) 400.

[6] Savings Bank *v.* Davis, 8 Conn. 191.

the usual place of residence of a director.[1] The right of all the directors to notice is founded on the right of being present for the purposes of consultation, of which right a minority cannot be arbitrarily deprived by a majority.[2] It follows that proceedings at a special meeting held by a bare majority of the members of a board of directors of a corporation, without notice to the other members, are void, although all those present voted in favor of the action taken, and the result would have been the same had the other members been present.[3] But all this proceeds upon the assumption that it is *practicable* to give notice; and it has accordingly been held that the action of the majority is not invalidated because absent directors, *out of the State*, failed to receive notice of the meeting.[4]

§ 3937. Notice of Adjourned Meetings must be Given. — Adjourned meetings are special meetings, and members not present when the adjournment took place must be notified. Where a regular meeting of the directors of a corporation, from which some of the members are absent, is adjourned to a future day, the hour of which is not fixed, the meeting, held on the day to which the adjournment was had, is a *special meeting*, of which notice is required to be given to the absentees at the regular meeting; and where no such notice is given, no act requiring the concurrence of a majority of the quorum can be done in such a case; an *assessment* levied at the adjourned

[1] Bank of Little Rock *v.* McCarthy, 55 Ark. 473; *s. c.* 29 Am. St. Rep. 60; 18 S. W. Rep. 759. It is held that a *statute* relating to the *service of notice* (Mansf. Dig. Ark. Stat., § 206) does not apply to notices of the meetings of business corporations. In this case a mortgage securing an existing debt and further advances was executed by the authority of three members of a board of five directors, at a special meeting at which four were present and participated, and of which the fifth had no notice. It did not appear that it was impracticable to notify the fifth, and it was held that the mortgage was void. *Ibid.*

[2] Com. *v.* Cullen, 13 Pa. St. 133; *s. c.* 53 Am. Dec. 450.

[3] Doernbecher *v.* Columbia City Lumber Co., 21 Or. 573; *s. c.* 28 Am. St. Rep. 766; 11 Rail. & Corp. L. J. 153; 28 Pac. Rep. 899.

[4] Chase *v.* Tuttle, 55 Conn. 455; *s. c.* 3 Am. St. Rep. 64; 12 Atl. Rep. 874. See also Halifax Sugar Ref. Co. *v.* Francklyn, 8 Rail. & Corp. L. J. 91.

meeting, in the absence of the former absentees, is a nullity.[1] It has been held that a minority of the directors of a railroad company, although legally assembled pursuant to call, *cannot* lawfully *adjourn* the meeting to a place fifty miles distant.[2]

§ **3938. These Principles Varied by Corporate Usage.**— The foregoing rules, like many other rules respecting the mode of corporate action,[3] may be overcome by proof of a contrary *habit* or *usage* of acting on the part of the directors. Thus, if the directors adopt a practice of giving their *separate assent* to the execution of contracts by their agents, it will have the same force as if done by a regular meeting of the board; otherwise the public could not deal with the corporation in safety.[4] So, it has been held that where the articles of association of a company do not prescribe the number of directors required to constitute a quorum, *the number who usually act* in conducting the business of the company will constitute a quorum.[5] So, where it was proved that *claims* against a corporation were *approved* by a majority of the board of directors, in accordance with the customary usage of the board in such cases, this was held sufficient proof of approval, in the absence of a law or by-law restricting the directors to a different mode.[6]

[1] Thompson *v.* Williams, 76 Cal. 153; *s. c.* 9 Am. St. Rep. 187; 18 Pac. Rep. 153.

[2] State *v.* Smith, 48 Vt. 266. As to *adjourned meetings*, see *ante*, §§ 720, 721.

[3] *Post*, § 5036.

[4] Bank of Middlebury *v.* Rutland &c. R. Co., 30 Vt. 159, 170. A later case in Vermont advances the untenable proposition that a formal meeting of the directors of a corporation is not necessary in order to enable them to do any act which is within their corporate powers. Waite *v.* Windham County Min. Co., 37 Vt. 608.

[5] Lyster's case, L. R. 4 Eq. 233; Lane *v.* Brainerd, 30 Conn. 565. So, where the words of a charter are doubtful, Rex *v.* Varlo, Cowp. 248, 250.

[6] Longmont Supply Ditch Co. *v.* Coffman, 11 Col. 551; *s. c.* 19 Pac. Rep. 508.

CHAPTER LXXVI.

DELEGATION OF THEIR POWER BY DIRECTORS.

SECTION
3944. How far directors may delegate their authority.
3945. Further of this subject.
3946. Directors may not delegate the power of making assessments.
3947. May delegate ministerial duties.
3948. Whether bank directors may delegate power to discount.
3949. May appoint and remove subordinate agents.
3950. Single director no power unless appointed agent.
3951. No power in directors to confer permanent and supreme control upon a single officer.
3952. May contract through a committee of their own members.
3953. Power of such committee to make contracts.
3954. To mortgage the property of the corporation.

SECTION
3955. Authority to convey includes power to execute suitable instruments.
3956. Powers of committees in respect of litigation.
3957. Such committee no power to purchase real estate.
3958. Power of committee appointed to examine and report.
3959. Power of building committees of church societies.
3960. Quorum of such committee necessary to act.
3961. *Ultra vires* acts of committees made good by ratification.
3962. Corporation bound by acts of such committee within their apparent authority.
3963. Personal liability of the members of such committees.

§ 3944. How Far Directors may Delegate their Authority.—It is a general principle of the law that where a power to act in a given particular has been delegated from one person to another, which power, from its nature, involves the exercise of *discretion*, and implies a *special trust* and *confidence* on the part of the donor in the donee, it can be executed only by the donee;[1] unless (1) the donor of the power has, in making the donation or outside of it, expressly or impliedly conferred the power to delegate it;[2] or (2) unless there is a *custom*

[1] Blore *v.* Sutton, 3 Meriv. 237.

[2] Shankland *v.* Washington, 5 Pet. (U. S.) 390; Brewster *v.* Hobart, 15 Pick. (Mass.) 302, 307; Lyon *v.* Jerome, 26 Wend. (N. Y.) 485; *s. c.* 37 Am. Dec. 271; Emerson *v.* Providence Hat Man. Co., 12 Mass. 237; *s. c.* 7 Am. Dec. 66.

in such cases that the power may be delegated by the donee, of such a nature and notoriety that the parties may be understood to have contracted with reference to it. It is proposed to consider how far this maxim applies to the delegation, by governing boards and committees of corporations, of the powers intrusted to them.[1]

§ **3945. Further of This Subject.**—Viewing the board of directors as the *agents* of the corporation,[2] a strict application of the principles of agency would render invalid a delegation of authority by this body which in its nature is purely personal, unless such a power of substitution could be found in the charter or by-laws.[3] Thus, it was held in an early New Hampshire case that, in the absence of evidence of the charter and by-laws, the court could not *judicially know* that a board of trustees of a corporation had any power to appoint an agent for any purpose whatever. Upon this principle it has been held that a board of directors could not delegate authority to a committee or agent to *mortgage* or *lease* real estate belonging to the corporation, as the exercise of these powers necessarily involves discretion and judgment.[4] So, a special act of the Legislature conferred upon an *orphan asylum* the power, by their managers, to *bind to service children* under their control. The managers were held to have no power under the act to delegate to a single individual the trust conferred upon themselves.[5] So, *by-laws* giving to the directors "a general

[1] Cases answering and illustrating this inquiry in other relations are: Stoughton *v.* Baker, 4 Mass. 522, 530; *s. c.* 3 Am. Dec. 236 (legislative committee); Lee *v.* Deerfield, 3 N. H. 290; and see Windsor *v.* China, 4 Me. 298 (town selectmen); Ball *v.* Dunsterville, 4 T. R. 313 (deed of *partners*); Chittinston *v.* Penhurst, 2 Salk. 475 (quorum of justices); Reg. *v.* West, 6 Mod. 180 (the same).

[2] *Post*, § 3969.

[3] Tippets *v.* Walker, 4 Mass. 595, 597.

[4] Gillis *v.* Bailey, 21 N. H. 149, 165; Despatch Line *v.* Bellamy Man. Co., 12 N. H. 205, 226; *s. c.* 37 Am. Dec. 203. See also Emerson *v.* Providence Hat Man. Co., 12 Mass. 237; *s. c.* 7 Am. Dec. 66; Manchester &c. R. *v.* Fisk, 33 N. H. 297; Lyon *v.* Jerome, 26 Wend. (N. Y.) 485; *s. c.* 37 Am. Dec. 271; York &c. R. Co. *v.* Ritchie, 40 Me. 425; Rex *v.* Gravesend, 4 Dow. & Ry. 117; *s. c.* 2 Barn. & C. 602.

[5] Female Orphan Asylum *v.* Johnson, 43 Me. 180.

superintendence and control over the affairs of the corporation," with power to sell lands and tenements, on such terms as they might deem advantageous, gave them no authority to *delegate* to an attorney power to lease the lands.[1] So, where the power of alloting or distributing unsubscribed shares in an incorporated company was vested by the deed of settlement in the board of directors, they had no right to delegate such power.[2] These decisions are based upon the principle that the directors themselves exercise an authority delegated by the corporation, a principle which, however, has been controverted by high authority.[3] The Supreme Judicial Court of Massachusetts, in opposition to the cases just noticed, have held that a board of bank directors might delegate an authority to a committee of their own number to *alienate* or *mortgage real estate*, and that such an authority necessarily implied an authority to execute suitable instruments, using the corporate seal for that purpose.[4] The court, speaking through Mr. Chief Justice Shaw, reasoned thus: "A board of directors of the banks of Massachusetts is a body recognized by law. By the by-laws of these corporations, and by usage so general and uniform as to be regarded as part of the law of the land, they have the general superintendence and active management of all concerns of the bank, and constitute, for all purposes of dealing with others, the corporation. We think they do not exercise a delegated authority, in the sense in which the rule applies to agents and attorneys, who exercise the powers especially conferred on them and no others."[5]

§ **3946. Directors may not Delegate the Power of Making Assessments.** — Of this nature is the power of making *calls*

[1] Gillis *v.* Bailey, 21 N. H. 149.

[2] Re Leeds Banking Co. (Howard's case), 1 L. R. Ch. App. 561; 12 Jur. (N. S.) 655; 14 Law Times (N. S.), 747.

[3] See *post*, § 3969, *et seq.*

[4] Burrill *v.* Nahant Bank, 2 Met. (Mass.) 163, 167; *s. c.* 35 Am. Dec. 395. See also Burr *v.* M'Donald, 3 Gratt. (Va.) 215; Ex parte Conway, 4 Ark. 302; Dana *v.* Bank of United States, 5 Watts & S. (Pa.) 223; Whitney *v.* Union Trust Co., 65 N. Y. 576.

[5] Burrill *v.* Nahant Bank, 2 Met. (Mass.) 163: *s. c.* 35 Am. Dec. 395.

upon stock.[1] It plainly involves the exercise of the broadest judgment and *discretion*.[2] This requires a knowledge of the necessities of the corporation, an accurate estimate of the amount of funds needed, an adjustment of the times of payment so as to cause as little inconvenience as possible to stockholders; therefore a board of directors will not be permitted to delegate to the treasurer of the company power to make calls in such installments as he shall deem fit, especially where the by-laws vest power to make calls not in the bare majority of a quorum of the directors, but require the assent of two-thirds of their whole number.[3]

§ **3947. May Delegate Ministerial Duties.** — There can be no doubt of the power of directors to delegate to others the performance of acts purely ministerial, as the *assignment* and *transfer* of *notes* and other *securities*.[4] Bank directors may also authorize the president and cashier to borrow money or *obtain discounts* for the use of the bank. In such cases, apparently for the purpose of facilitating transactions, the authority granted by resolution of bank directors to officers of the bank has been liberally interpreted. Thus, the president and cashier being authorized by a resolution of the directors to raise money for the use of the bank, it is not necessary that both should sign the instrument used for this purpose; it is sufficient that both agree upon a plan of borrowing money, the details of which may be executed by either officer.[5]

§ **3948. Whether Bank Directors may Delegate Power to Discount.** — If, therefore, the act of incorporation of a bank requires *discounts* to receive the assent of four directors, the

[1] *Ante*, § 1706.

[2] It is a very high power of a summary nature, and may involve a loss or forfeiture of the shares of the corporators in case of a non-compliance with the requisition. *Per* Mr. Justice Story, in Ex parte Winsor, 3 Story (U. S.), 411, 425.

[3] Silver Hook Road *v.* Greene, 12 R. I. 164; *s. c.* 7 Reporter, 187.

[4] Northampton Bank *v.* Pepoon, 11 Mass. 288; Spear *v.* Ladd, 11 Mass. 94; Folger *v.* Chase, 18 Pick. (Mass.) 63; Stevens *v.* Hill, 29 Me. 133.

[5] Fleckner *v.* Bank of United States, 8 Wheat. (U. S.) 338; Ridgway *v.* Farmers' Bank, 12 Serg. & R. (Pa.) 256, 258; *s. c.* 14 Am. Dec. 681.

directors will not be permitted to delegate to the president and cashier the authority to discount bills and notes without the intervention and assent of the four directors.[1] Chancellor Walworth seems to have been of the opinion that it was a violation of duty on the part of the directors to allow the president and cashier *unlimited discretion* in the matter of discounts. Bank directors, however, were not permitted to profit by their own wrong in this matter. Accordingly, he held that if the board of directors authorize or allow their president or cashier, or any other officer of the bank, to make loans or discounts in his own discretion, without having the same formally passed on at a regular meeting of the board, such loans must be presumed to have been made by the authority of the board of directors; and therefore if in excess of the limit fixed by law, or in violation of the charter of the bank, the corporation would be liable for the violation of its charter in this particular.[2] The modern view and practice undoubtedly are for the directors of banks to commit the discounting of ordinary commercial paper to a committee of their own members, often to their president and cashier, or to either of those officers separately.

§ 3949. May Appoint and Remove Subordinate Agents. — While, therefore, those powers of directors which involve the exercise of a *discretion*, in their collective character as a board, in the management of the company's affairs, cannot be delegated,[3] yet it is within the contemplation of all schemes of incorporation that the board of directors or trustees shall have the power to appoint and discharge subordinate agents to do the ministerial work of the company.[4] They may constitute *one of their number* an agent of the corporation for the transaction of a particular piece of business, and the corporation will be bound by such contracts as are made by this director looking to its performance.[5]

[1] Percy *v.* Millaudon, 8 Martin, (N. S.) (La.) 68; *s. c.* 3 La. 568. See also Manderson *v.* Commercial Bank, 28 Pa. St. 379.

[2] Bank Commissioners *v.* Bank of Buffalo, 6 Paige (N. Y.), 497.

[3] *Ante*, § 3944.

[4] *Post*, § 4873.

[5] Merrick *v.* Reynolds &c. Co., 101 Mass. 381.

§ 3950. Single Director No Power unless Appointed Agent. — A director is authorized to act only *as a member of the board* in matters touching the business concerns of the corporation and the management of its affairs; otherwise he has no authority to represent the corporation, or to bind it by his acts, unless authorized by some proper action of the board, in which case he acts precisely like any other agent of the corporation, and upon the same authority; and his authority to act must be shown by a resolution of the board, by verbal appointment, or by the approbation and acquiescence of the board of directors in his acts.[1] He cannot bind the corporation by his declarations, or put a construction upon its contracts.[2]

§ 3951. No Power in Directors to Confer Permanent and Supreme Control upon a Single Officer. — The president and one of the directors, though constituting a majority of the executive committee, have no authority to make a contract providing that a certain person, except for good and sufficient cause shown for his removal, shall have the permanent and supreme control in the management of the company's road and interests; nor can the executive committee make such a contract, unless, perhaps, the by-laws or the board of directors, under the authority of a by-law, confer such authority. Indeed, it is doubtful whether the entire board of directors, or even the corporation itself, can invest a person with such permanent and supreme control of corporate affairs; because such an arrangement would work a virtual abolition of the board of directors.[3] Thus, where the articles of association provided that the directors should

[1] *Ante*, § 3906; Chicago &c. R. Co. *v.* James, 22 Wis. 194; National Bank *v.* Norton, 1 Hill (N. Y.), 572, 579; Hartford Bank *v.* Hart, 3 Day (Conn.), 491, 495; *s. c.* 3 Am. Dec. 274; Harper *v.* Calhoun, 7 How. (Miss.) 203; Shackleford *v.* New Orleans &c. R. Co., 37 Miss. 202.

[2] Hartford Bridge Co. *v.* Granger, 4 Conn. 142.

[3] Queen *v.* Second Ave. Ry. Co., 3 Jones & Sp. (N. Y.) 154; *s. c.* 44 How. Pr. (N. Y.) 281. See also Auburn Academy *v.* Strong, 1 Hopk. Ch. (N. Y.) 278.

have power to appoint and remove agents of the corporation, it was held that a contract with A., agreeing to appoint B. the agent and manager of all the mining property of the corporation, and that B. should be retained in that position until B. should pay A., out of the profits, a certain sum which A. claimed was due him, and that B. should be removable at A.'s pleasure, — was one which the directors had no power to make, and was not binding upon the corporation.[1]

§ 3952. May Contract through a Committee of their Own Members. — A corporation, unless expressly restrained by its charter, may contract through the agency of a select committee of its members.[2] Accordingly, where an act of Congress

[1] Flagstaff Silver Mining Co. *v.* Patrick, 2 Utah, 304.

[2] Berks &c. Co. *v.* Myers, 6 Serg. & R. (Pa.) 12, 16; *s. c.* 9 Am. Dec. 402. In New York a banking association formed under the general law of 1838, might, by its articles of association and by-laws, divide the business it was authorized to transact into several distinct *departments*, and constitute a *separate committee of directors* for each department; or might intrust to a separate committee of the directors the exclusive charge of each department, clothing that committee with all the powers of a board, in relation to the business which its department embraced. Palmer *v.* Yates, 3 Sandf. (N. Y.) 137. By the articles of association of such a bank, the directors, as a board, were authorized to make such by-laws, rules, and regulations, for the management of the business of the company, and the government of themselves, their officers and agents, as they might think expedient, not inconsistent with law and the articles of association. The by-laws which they made declared that the business of the company should be conducted under *two divisions;* the first to embrace the business relating to bonds, mortgages, and other securities, and the second the business of discount and deposit; and also established *two departments* corresponding with the divisions, and placed them under distinct committees. It was held: 1. That such a system was neither inconsistent with law nor with the articles of association; that this provision was intended to cover the whole business of the company; and that the business of the first department included the transfer and assignment, as well as the taking, of mortgages and other securities. 2. That under such a division of the business, a resolution of the committee of investments and finance must be deemed a "resolution of the board of directors," within the meaning of 1 N. Y. Rev. Stat. 591, relating to moneyed corporations. *Ibid.* So, the trustees of a New York manufacturing corporation may, under a statute of that State (1 Rev. Stat. N. Y., p. 599, § 1, subsec. 5), authorizing them to appoint such subordinate officers and agents as its business shall require, appoint an executive

chartering the Union Pacific Railroad Company, incorporated the body of stockholders and conferred upon them the power to make by-laws touching all matters whatsoever, which might pertain to the concerns of the company, and they made a by-law vesting the "whole charge and management of the property" of the company in the board of directors, but at the same time authorizing it to delegate to an *executive committee* the power to do any acts which the board itself might do, it was held that this authorized the substitution of the executive committee for the board, in such a sense as to render the assent of the board unnecessary to a contract made by the executive committee and ratified by the stockholders, whereby the railroad company conceded to another such company for nine hundred and ninty-nine years the right to a joint use of its bridge across the Missouri River.[1] On the other hand, a duty which is imposed by statute upon the president and directors cannot be shifted by them upon an executive committee appointed under the by-laws. Thus, if the governing statute imposes on the president and directors of a railroad company the duty of *locating the road*, they cannot shift this duty upon an executive committee, having under the by-laws no more than a "general supervision of the operations and policy of the company," with a general power to make such contracts as they may deem expedient; but, a location made by such a committee being *ultra vires*, does not invalidate a subsequent location, upon the same ground by *another corporation* having the right of eminent domain.[2] So, it has been said, with reference to a turnpike company, that the power of the directors to appoint a committee to enter into a contract on behalf of the corporation, thereby delegating their own

committee of their own members, with power to transact the business of the corporation when the board is not in session; and such committee may delegate to one of its members power to indorse checks received by the company upon a contract and receive the money thereon. Sheridan Electric Light Co. *v.* Chatham Nat. Bank, 127 N. Y. 517; *s. c.* 40 N. Y. St. Rep. 311; 28 N. E. Rep. 467.

[1] Union Pacific R. Co. *v.* Chicago &c. R. Co., 51 Fed. Rep. 309.

[2] Weidenfeld *v.* Sugar Run R. Co., 48 Fed. Rep. 615.

powers, will not be presumed, but that it must appear that the corporation has conferred upon them such power of delegation.[1]

§ 3953. Power of Such Committee to Make Contracts.— The power of such a committee to make contracts which shall bind the corporation depends upon two considerations: 1. The nature of the contract: Whether it is a contract of such a nature that the board of directors *could* delegate the power to make it. 2. Whether they *have* delegated such power.[2] Some analogy for a conclusion on this question may be found in holdings touching the powers of New England *town committees.* It has been held that such a committee, appointed to *rebuild a bridge,* have implied power to bind the town by the *necessary contracts* for building, although also authorized by vote to borrow money for the purpose of rebuilding.[3] But a power to manage *ad interim* and "to do all the acts necessary for the prosperity of the society in the intervals of the meetings of the board," does not empower such a committee of the trustees of an agricultural society to purchase real estate.[4]

[1] Tippets *v.* Walker, 4 Mass. 595, 597. Where the amount of shares authorized by the articles of incorporation of a railroad company had been issued by the president under authority of the executive committee, and the issue had not been authorized or ratified by the board of directors, they carried no right to be admitted as a shareholder to one who was not a purchaser in good faith and for full value. Ryder *v.* Bushwick R. Co., 134 N. Y. 83; *s. c.* 45 N. Y. St. Rep. 388; 31 N. E. Rep. 251.

[2] A contract within the powers of a corporation, signed and attested by the proper officers, approved by the executive committee vested *ad interim* with all the powers of the board, under authority of a delegation of such powers from the directors, to make which they were empowered by by-laws authorized by the charter and approved by two-thirds of all the stockholders being all present at a regular meeting—is *fully authorized, duly executed,* and *binding.* Chicago &c. R. Co. *v.* Union Pac. R. Co., 47 Fed. Rep. 15; *s. c.* 10 Rail. & Corp. L. J. 283.

[3] Simonds *v.* Heard, 23 Pick. (Mass.) 120; *s. c.* 34 Am. Dec. 41. And see Damon *v.* Granby, 2 Pick. (Mass.) 345. But see Kupfer *v.* South Parish in Augusta, 12 Mass. 185; Hayward *v.* Pilgrim Society, 21 Pick. (Mass.) 270.

[4] Tracy *v.* Guthrie County Agricultural Society, 47 Iowa, 27.

§ 3954. To Mortgage the Property of the Corporation.— No doubt, as a general proposition, the president and cashier of a bank, and a "*finance committee*" of the board of directors, as such merely, have no power to execute a mortgage on the lands of the corporation, without the concurrence of the board of directors; and where such mortgage was executed by such officers of a banking corporation, without the authority of the directors, to whom, by the charter, the management of its affairs was committed, the mortgage was held to be void, although in fact the management of its affairs was committed, for the most part, to the president and cashier.[1] But associations organized under the general banking law of New York of 1838, might, by their articles of association and by-laws, provide that the board of directors might apportion its work among committees of its members, each of which should possess, within the limits assigned to it, the powers of the full board.[2] Hence it was held that the committee of the board of directors on finance of the North American Trust & Banking Company of New York, had the power, under its articles of association and by-laws, to authorize the president and cashier to make an agreement and trust deed to secure the repayment of a loan to the company.[3] And we have already[4] had occasion to note a holding in Massachusetts to the effect that the board of directors of a banking corporation may, if they see fit, delegate to a committee of their members the power to mortgage the real estate of the bank to secure its debts.[5]

§ 3955. Authority to Convey Includes Power to Execute Suitable Instruments.—The authority thus delegated by the board of directors to a *committee* of their own number, to convey or mortgage real estate, of course includes the power to execute suitable instruments for that purpose and to affix the

[1] Leggett *v.* New Jersey Man. &c. Co., 1 N. J. Eq. 541; *s. c.* 23 Am. Dec. 728.

[2] Palmer *v.* Yates, 3 Sandf. (N.Y.) 137.

[3] Leavitt *v.* Blatchford, 5 Barb. (N. Y.) 9; but see *s. c.* 3 N. Y. 19.

[4] *Ante*, § 3945.

[5] Burrill *v.* Nahant Bank, 2 Met. (Mass.) 163; *s. c.* 35 Am. Dec. 395.

corporate seal to an instrument which requires the seal to be affixed.[1] This is in conformity to the general rule that whenever an agent is empowered to do a particular thing, he is also empowered to use the means necessary to accomplish the object intended.[2] Thus, if an agent is empowered to procure a bank to *discount* commercial paper, he is, by implication, empowered to *indorse* his principal's name upon it, to the end that it may be discounted.[3] The execution of the necessary written instruments to effectuate the powers thus possessed by such committee being a mere *ministerial act*, the committee has, no doubt, the power to appoint an *attorney in fact* or *subagent* to execute such instruments.[4]

§ 3956. Powers of Committees in Respect of Litigation. A committee consisting of the president, secretary, and treasurer, duly authorized *to collect* all outstanding amounts due the corporation, may *institute a suit* for this purpose in the name of the corporation, without further authority from the board of directors.[5] A committee of the proprietors of a canal having, in behalf of such proprietors, entered into a *submission* of demands *to referees*, under a statute, representing themselves as duly authorized to do so, and the proprietors having been heard upon the merits before the referees, making no objection to the submission;—upon error brought by the proprietors to reverse a judgment rendered upon the award, the *authority* of the committee to enter into such submission was *conclusively presumed*, although this circumstance was assigned for error.[6] The regulations of an association provided for a standing *committee to act as arbitrators* to settle disputes between the members; their report to be in writing, and to be binding and final as to the parties to the arbitra-

[1] Burrill *v.* Nahant Bank, 2 Met. (Mass.) 163; *s. c.* 35 Am. Dec. 395.

[2] Merchants' Bank *v.* Central Bank, 1 Ga. 418; *s. c.* 44 Am. Dec. 665.

[3] *Ibid.*

[4] *E. g.*, to indorse certain negotiable paper: Sheridan Electric Light Co. *v.* Chatham National Bank, 5 N. Y. Supp. 529; *s. c.* 52 Hun, 575.

[5] St. Louis Domicile &c. Asso. *v.* Augustin, 2 Mo. App. 123.

[6] Fryeburg Canal *v.* Frye, 5 Me. 38.

tion. Upon a voluntary submission to parties without regard to their official capacity, but merely as arbitrators,—it was held that a finding of the arbitrators under such submission was binding, though rendered *orally*.[1]

§ **3957. Such Committee No Power to Purchase Real Estate.**—A committee authorized by the articles of incorporation "to do all acts necessary for the prosperity of the society in the intervals of the meeting of the board," have not power to purchase real estate, especially where the purchase is not assented to by the entire committee, but only by a majority thereof. The power above stated simply authorizes the executive committee, in the interval of the meetings of the board, to do acts, from the omission of which, the prosperity of the society would suffer. In this case, the president, having power to call meetings of the board whenever he might deem it expedient, the society could suffer no detriment from the purchase being deferred until it could be submitted to the action of the board.[2]

§ **3958. Power of Committee Appointed to Examine and Report.**—Committees merely to examine and report to the full board upon a given question are not *executive committees*, and hence are not such committees as we are dealing with in this discussion. Their report is merely advisory, and does not possess the quality of a corporate *act*, unless it is acted upon by the directors or by the corporation. Hence, it has been held that the report of a committee of an *ecclesiastical society*, not acted upon by the society, is not *evidence* against the society; and that, if acted upon, it could not be shown by *parol* testimony.[3]

[1] Murdock *v.* Blesdell, 106 Mass. 370.

[2] Tracy *v.* Guthrie County Ag. Soc., 47 Iowa, 27.

[3] Southington Ecclesiastical Society *v.* Gridley, 20 Conn. 200. In another case the trustees of a university being authorized, by special act, to change the location of the institution, provided they should file with the Secretary of State a resolution by a majority of all the members of the board, electing to make such change, —the board appointed a committee to

§ 3959. Power of Building Committees of Church Societies.—These committees may not fall strictly within the class of committees we are here considering, because they are often appointed from the body of the *members*, and not necessarily from the body of the *trustees*. They have, roughly speaking, whatever powers are conferred upon them by voluntary action, and this is rather a matter of private contract, like the appointment of an ordinary agent, than a question pertaining to the law of corporations. A *committee* chosen by a *town* "to procure a master-builder and superintend the building of a meeting-house for the town," with authority to borrow money if necessary, have power to make contracts for the building, where no special committee is appointed for that purpose.[1] When so appointed from the body of the members, not being themselves trustees, the principle that directors or trustees cannot contract with themselves without committing a breach of their trust, no doubt applies to them, in the sense which prohibits them from being on both sides of a contract touching the building of the church or other edifice or structure. But, according to one holding this is not so where, by accepting the contract, the committee did not assume a *personal undertaking* to build the house. At least such a contract will authorize a recovery against the society *at law*.[2]

§ 3960. Quorum of Such Committee Necessary to Act.—As in the case of the full board of directors or trustees, there

examine legal difficulties interposed, and hear arguments; and provided that if the committee should report that the difficulties were not sufficient to prevent a removal, the resolution of the board should be absolute, and the officers of the board should be thereupon authorized to file in the Secretary of State's office, a resolution in a prescribed form, purporting to be the election of the board. It was held that, even if this were to be deemed an authorized delegation of power, the committee had no authority to file the resolution, until all the members of the committee had met, examined the legal difficulties, heard arguments upon them, and reported that they were insufficient. Hascall *v.* Madison University, 8 Barb. (N. Y.) 174.

[1] Damon *v.* Granby, 2 Pick. (Mass.) 345, 351.

[2] Sawyer *v.* Methodist Epis. Soc., 18 Vt. 405.

is a difference of opinion upon the question whether all the members of such a committee must unite in any action in order to bind the corporation, or whether a majority may effectively act.[1] On the one hand, it has been reasoned that, in general, if a number of persons are appointed by a corporation for a particular purpose, *all must act;* and that no contract can be made by a portion of them, although a majority, which will bind the corporation.[2] Another court has held that a sale of land by a portion, though a majority, of a board of *public commissioners,* does not pass a good title. The court reason that a *majority may control,* yet *all must meet and consult,* or at least have *notice* of the meeting so that they may attend if they desire. And this seems to be the view founded in ancient precedent.[3] Therefore, in the opinion of the court, a general resolution passed by the whole board of commissioners a year before, that they would sell all the city property to pay its debts, did not give validity to the sale of a particular lot subsequently made, in pursuance of a resolution adopted by the board, when two of the five were absent.[4] Perhaps the practical view is, that while no valid act can be done by a minority of such a committee,[5] unless the act be *ministerial* merely and the number of members acting have received a special authorization,[6] yet, in the absence of any by-law of a municipal corporation to the contrary, a majority of a committee, to whom is referred a project, constitute a quorum and are competent to act on the subject matter,[7]—

[1] *Ante,* § 3905, *et seq.*

[2] Corn Exchange Bank *v.* Cumberland Coal Co., 1 Bosw. (N. Y.) 436.

[3] *Ante,* § 706.

[4] Leonard *v.* Darlington, 6 Cal. 123.

[5] McNeil *v.* Boston Chamber of Commerce, 154 Mass. 277; *s. c.* 28 N. E. Rep. 245.

[6] *Ante,* § 3947. Thus, if a committee of three directors has discretionary power for the execution and delivery of a lease of the corporate property, two of the members may seal it with the corporate seal, where the third is absent, but has approved its terms and concurred with the others in directing its engrossment for execution. But in the particular case one of the members executing the instrument was president of the corporation and custodian of its seal. Union Bridge Co. *v.* Troy &c. R. Co., 7 Lans. (N. Y.) 240.

[7] State *v.* Jersey Cy., 27 N. J. L. 493. And see Junkins *v.* Doughty Falls &c. School District, 39 Me. 220.

provided, of course, all have notice and opportunity to attend and consult.

§ 3961. Ultra Vires Acts of Committees Made Good by Ratification. — *Ultra vires acts of such committees* stand on the same footing as the *ultra vires* acts of directors and other corporate officers and agents;[1] they do not bind the corporation, but stand as nullities so far as it is concerned, unless the corporation or the stockholders have *ratified* them, or unless the corporation or the stockholders have assumed such a position in respect of them as to be equitably *estopped* from repudiating them.[2] As elsewhere seen,[3] a ratification is generally predicated on the fact of an *acquiescing after knowledge.* Thus, where the matter is such that the directors in full board might bind the corporation, an acquiescing by the board in an act of a committee of its members, with knowledge thereof, is sufficient to bind the corporation.[4] Hence, where a material fact has been concealed, and those whose acquiescence would otherwise amount to a ratification have not been guilty of negligence in failing to discover it, there may be a repudiation after such fact becomes known. Thus, it has been held that a contract made by a committee of the directors of a railroad company with a third person, giving him the right to prospect for coal upon the company's lands, and agreeing to buy coal from him, may be repudiated by the corporation, on discovering that officers who negotiated it had a *secret interest* in it, not-

[1] *Post,* § 5968, *et seq.*

[2] Thus, where an action was brought against a corporation on a promissory note given by them for the purchase of lands, which note was signed by their committee, who also made the purchase, and it appeared that such committee had power to make the contract for the lands, but not to give the note, it was held that no recovery could be had on the note against the corporation, but that the plaintiffs could recover upon the count for lands sold and conveyed. Chestnut-Hill Reservoir Co. *v.* Chase, 14 Conn. 123. On the other hand, a ratification *by the stockholders* of the acts of an executive committee seems to render unnecessary a formal ratification *by the directors:* Union Pacific R. Co. *v.* Chicago &c. R. Co., 51 Fed. Rep. 309.

[3] *Post,* § 5298.

[4] McNeil *v.* Boston Chamber of Commerce, 154 Mass. 277; *s. c.* 28 N. E. Rep. 245.

withstanding it has been for a long time acted upon.[1] Again, the corporation cannot disaffirm and at the same time *keep the benefits* which have accrued to it from the unauthorized act of the committee;[2] but this is consistent with the principle that keeping the benefits without knowledge of the wrong is not necessarily an affirmance. Within the limits of these well-known principles, a ratification by a corporation of the acts of such a committee is equivalent to a precedent authorization, and cures defects in the original appointment.[3]

§ 3962. Corporation Bound by Acts of Such Committee Within their Apparent Authority. — As in the case of other agents, a *secret* or unknown *limitation* upon the authority of a committee of the directors of a corporation, imposed by the stockholders, will not control an *apparent authority* given by the board of directors, within the scope of their general authority.[4]

§ 3963. Personal Liability of the Members of Such Committees. — Members of the *executive committees* of corporations are personally liable, on the footing of directors and trustees, for losses happening through their mismanagement.[5]

[1] Wardell *v.* Union Pacific R. Co., 4 Dill. (U. S.) 330.

[2] Sheridan Electric Light Co. *v.* Chatham Nat. Bank, 52 Hun (N. Y.), 575; *s. c.* 24 N. Y. St. Rep. 622; 5 N. Y. Supp. 529; *post,* § 5303. Compare *post,* § 6007.

[3] Madison Ave. Baptist Ch. *v.* Baptist Ch. in Oliver St., 2 Abb. Pr. (N. S.) (N. Y.) 254; *s. c.* 32 How. Pr. (N. Y.) 335.

[4] McNeil *v.* Boston Chamber of Commerce, 154 Mass. 277; *s. c.* 28 N. E. Rep. 245.

[5] Williams *v.* McKay, 46 N. J. Eq. 25; *s. c.* 18 Atl. Rep. 824.

CHAPTER LXXVII.

POWERS OF DIRECTORS.

SECTION
3967. Nature of the office in general.
3968. Divergent views as to the nature and limits of the powers of directors.
3969. English view that they are special agents only.
3970. View that directors may do whatever the corporation may do.
3971. But cannot do more.
3972. Effect of by-laws limiting their powers.
3973. Their powers not extended by by-laws.
3974. Authority within what limits supreme.
3975. The stockholders cannot act for the company.
3976. Exceptions and qualifications of this rule.
3977. Further of this rule.
3978. Directors have no common-law powers.
3979. No power to make constituent changes.
3980. Cannot apply for or accept amendment of charter.
3981. Nor accomplish this result by indirect means.
3982. Cannot make, alter, or annul by-laws.
3983. May not sell out corporate assets and business.
3984. But may alien corporate real estate in course of business.

SECTION
3985. May mortgage corporate property.
3986. May assign for benefit of creditors.
3987. When assign to other trustees.
3988. May borrow money.
3989. May make and transfer negotiable paper.
3990. May assume or guarantee debts of other persons or corporations, when.
3991. May fix the salaries of corporate officers.
3992. May not fix price of shares of stock.
3993. Powers in levying assessments.
3994. When release corporate interest.
3995. Cannot give away its assets.
3996. But may make *bona fide* compromises.
3997. And conduct corporate, but not private, litigation at corporate expense.
3998. Powers of directors of banking companies.
3999. Effect of *ultra vires* acts of directors.
4000. Loss of power by lapse of time.
4001. Instances of their ordinary contracting powers.
4002. Powers under particular instruments.
4003. Their contracts not voidable because of errors of judgment.

§ **3967. Nature of the Office in General.** — The management of private corporations is usually vested in certain officers and boards; the body of the members having no voice therein except in their election.[1] It is plain that a corporation cannot be bound by the declarations or acts of individual members, because unanimity of sentiment under such circumstances would be impossible.[2] The voice of the corporators can be heard only when speaking in a body.[3] As stated by Sir N. Lindley: "Before a company is formed, those engaged in forming it are not partners and are not each others' agents for doing that which may be necessary to form the company; and after a company is formed, the transaction of its business is notoriously intrusted to a few directors or managers, and other members take no part in it."[4] In business corporations the managing board is usually called the board of *directors*, though sometimes it is called the board of *trustees;* while in eleemosynary corporations it is usually called the board of *trustees* or the board of *guardians* or *curators*. In some statutory schemes of incorporation the word "director" is defined to embrace all persons having by law the direction or management of the affairs of any such corporation, by whatever name they may be described in its charter or known in law.[5]

§ **3968. Divergent Views as to the Nature and Limits of the Powers of Directors.** — Three radically different views are entertained in answer to this question: 1. That the directors,

[1] Bank of United States *v.* Dandridge, 12 Wheat. (U. S.) 64, 113; Com. *v.* St. Mary's Church, 6 Serg. & R. (Pa.) 508; Ridgway *v.* Farmers' Bank, 12 Serg. & R. (Pa.) 256; *s. c.* 14 Am. Dec. 681.

[2] *Ante*, § 3905, *et seq.*

[3] Ruby *v.* Abyssinian Soc., 15 Me. 306; Hayden *v.* Middlesex Tp. Corp., 10 Mass. 397, 403; 6 Am. Dec. 143; Canal Bridge *v.* Gordon, 1 Pick. (Mass.) 297, 304; *s. c.* 11 Am. Dec. 170; University of Maryland *v.* Williams, 9 Gill & J. (Md.) 365; *s. c.* 31 Am. Dec. 72; Wheelock *v.* Moulton, 15 Vt. 519, 522; Harris *v.* Muskingum Man. Co., 4 Blackf. (Ind.) 267; *s. c.* 29 Am. Dec. 372. The distinction between a corporation and the aggregate of the members forming such corporation is well illustrated by the case of Society of Practical Knowledge *v.* Abbott, 2 Beav. 559.

[4] Lindley on Part. 240. See Bramah *v.* Roberts, 3 Bing. N. C. 963.

[5] Rev. Stats. N. Y. (Banks & Bros. 6th ed. 1876), Vol. II, p. 303, § 56; Comp. Laws Utah, 1876, p. 637, § 333. So, in Cal. Penal Code, § 572.

being the chosen representatives of the corporation, constitute, for all purposes of dealing with others, *the corporation itself;* hence, that within the scope of the objects and purposes of the corporation they have all the powers of the corporation itself. 2. That the directors have all the powers of *general agents* in the management of corporate affairs. 3. That they have only the powers of *special agents;* therefore, that the public are bound to take notice of the limits of their authority as settled by the corporate body. In an early and leading case, the Supreme Court of the United States resolved itself against the first of these views, Mr. Justice Story giving the opinion, and Chief Justice Marshall dissenting. The case was that of a *banking corporation,* and the majority of the court were clearly right in holding that the directors of such a corporation are not the corporation itself. On the other hand, there are many cases, especially those of *eleemosynary corporations,* where the trustees are the body which is incorporated, and are hence the corporation. Coming back to the case of a business corporation, it is plain that the directors cannot be considered, in a strict sense, as the agents of the stockholders; for, although they are elected by the body of the stockholders, they are *mandataries* charged with the general business of the corporation, and the stockholders cannot take that business out of their hands and do it in their stead,[1] as a principal can revoke the appointment of his agent and do the business himself. They cannot be regarded in a strict sense as agents, because they derive their powers largely *from the law,* and not by a mere delegation from the stockholders who elect them. Nevertheless, they are agents in such a

[1] *Ante,* § 1075; *post,* § 3975. Note the illustration of Comstock, C. J., in Bissell *v.* Michigan &c. R. Co., 22 N. Y. 264. See Madison &c. R. Co. *v.* Norwich Saving Soc., 24 Ind. 457; State Bank *v.* State, 1 Blackf. (Ind.) 267; *s. c.* 12 Am. Dec. 234. The powers and duties of directors are such that, in the general management of the business of the corporation, their negligence may be called the negligence of the corporation, in contradistinction to the negligence of its servants. Fifield *v.* Northern R. R., 42 N. H. 225, 236; Columbus &c. R. Co. *v.* Arnold, 31 Ind. 174; *s. c.* 99 Am. Dec. 615.

sense that in many cases their acts, otherwise voidable, become valid by the *ratification* of the stockholders.[1] They are treated by Sir Nathaniel Lindley as *agents*,[2] and there appears to be a difference of judicial opinion in *England* upon the question whether they are to be regarded as *general* or as *special* agents.[3] Indeed the whole doctrine of *ultra vires* in its *secondary sense*,[4] where the inquiry is whether a given act, although within the general powers of the corporation, is void as not within the powers of the directors, rests upon this conception. Chief Justice Shaw, on the other hand, advances the view that the directors of a bank "constitute to all purposes of dealing with others, the corporation." "We think," said he, "they do not exercise a delegated authority in the sense in which the rule applies to agents and attorneys, who exercise the powers specially conferred on them and no others."[5] But on the whole, judicial theory, at least in America, greatly preponderates in favor of the proposition that the directors of a business corporation are its *general* or managing agents.[6] But perhaps the importance of this distinction is more fancied than real.[7]

[1] *Post*, § 5314.

[2] Lind. Comp. Law (5th ed.), 155.

[3] See *post*, § 3969.

[4] *Post*, § 3969.

[5] Burrill *v.* Nahant Bank, 2 Met. (Mass.) 163, 167; *s. c.* 35 Am. Dec. 395. See also Maynard *v.* Fireman's Fund Ins. Co., 34 Cal. 48; *s. c.* 91 Am. Dec. 672.

[6] Stark Bank *v.* United States Pottery Co., 34 Vt. 144, 148; State *v.* Smith, 48 Vt. 266; Bank *v.* Rutland &c. R. Co., 30 Vt. 159, 169; Branch Bank *v.* Collins, 7 Ala. 95; Lincoln &c. Bank *v.* Richardson, 1 Me. 79, 81; *s. c.* 10 Am. Dec. 34; Spyker *v.* Spence, 8 Ala. 333; Bedford R. Co. *v.* Bowser, 48 Pa. St. 37; Dana *v.* Bank of United States, 5 Watts & S. (Pa.) 223; Dayton &c. R. Co. *v.* Hatch, 1 Disney (Ohio), 84; Mechanics' Bank *v.* New York &c. R. Co., 13 N. Y. 599, 640; Simons *v.* Vulcan Oil &c. Co., 61 Pa. St. 202, 221; *s. c.* 100 Am. Dec. 628; Brokaw *v.* New Jersey &c. Trans. Co., 32 N. J. L. 328; *s. c.* 90 Am. Dec. 659; Chetlain *v.* Republic Life Ins. Co., 86 Ill. 220; Bank of Kentucky *v.* Schuylkill Bank, 1 Pars. Sel. Cas. 180, 235; Goodwin *v.* United States Ins. Co., 24 Conn. 591; Wright *v.* Bundy, 11 Ind. 398; Leavitt *v.* Yeates, 4 Edw. Ch. (N. Y.) 134.

[7] The question as to whether boards of directors are to be considered as acting in an individual capacity, *i. e.*, as agents of the corporation itself, has arisen in the case of directors acting outside of the State creating their corporation. If the action of the board of directors in

§ 3969. English View that they are Special Agents Only. In England, the ingenuity of the bench has been taxed to demonstrate that they are not even general agents of the corporate body, a proposition which would never be discussed in an American court. Thus, an authoritative writer says, in speaking of the powers of corporate agents: "The first question which arises with reference to this subject is, whether the directors are to be regarded as the general agents of the company, for the purpose of transacting its business, or whether they are to be regarded as its special agents for certain defined purposes, and for those only. Upon this question opinions have greatly differed, but the tendency of the courts is in favor of holding directors to be special rather than general agents."[1] To illustrate: The deed of settlement of a mining corporation provided that the affairs and business of the company should be under the sole and entire control of the directors. It appeared from the circumstances of the case, and the jury found as a fact, that it was necessary for the proper working of the mines that money should be *borrowed.* Notwithstanding this fact, the court held that the directors had no such power.[2] It is conceived that no American court would hesitate to decide otherwise.[3] A judicial decision was

such cases is to be sustained, it must be upon the theory that they act simply as the agents of their corporations. Bank of Augusta *v.* Earle, 13 Pet. (U. S.) 519, 521; Wright *v.* Bundy, 11 Ind. 398. And such is the view generally adopted. Thus, it was held competent for the directors of a manufacturing company, whose charter contained no restriction as to the place of holding their meetings, to meet in another State, and there appoint a secretary of the company. McCall *v.* Byram Man. Co., 6 Conn. 428. And so for the directors of a railroad corporation to confer authority upon an agent to execute a corporate deed. Arms *v.* Conant, 36 Vt. 744; Bellows *v.* Todd, 39 Iowa, 209. The Supreme Court of Maine, however, in a case of this kind, where the organization of the company under their charter was attempted outside of the State granting the same, held that the corporation was not created by the grant of the charter simply; that organization thereunder within the State was necessary to perfect the corporate existence; that as the first and only board of directors was elected by the corporators outside of the State, such board was not duly organized and was therefore incapable of authorizing their president and secretary, by another meeting outside of the State, to execute a mortgage of property of the corporation so called, located within the State granting the charter. Miller *v.* Ewer, 27 Me. 509; *s. c.* 46 Am. Dec. 619. See *ante,* §§ 694, 696.

[1] Lindley on Partnership (4th ed.), 249.

[2] Burmester *v.* Norris, 6 Exch. 796; *s. c.* 8 Eng. L. & Eq. 487.

[3] *Post,* §§ 3988, 5697.

also necessary to establish that a board of directors having authority to issue "a" promissory note, or accept "a" bill of exchange for a certain sum, were not precluded from *giving security* for such sum, with its legal accretions, by several notes or bills, instead of a single note or bill.[1] Lord Mansfield admitted that it was "a captivating argument" for a jury, in suits against joint-stock companies, that the company had had the benefit of the plaintiff's goods, service or money; but he answered this by saying that "for the purposes of contract, the company exists only in the directors and officers acting by and according to the deed."[2] The English and American courts thus dividing upon a fundamental proposition, much misconception is apt to be generated by this circumstance, in considering the validity of acts of directors, unless this fact be constantly present to the mind. The apparent impolicy of the English decisions is in some measure tempered by a consideration noticed by the learned writer above quoted: "At the same time," he says, "it is established that what the directors of a company have power to do, and do in the name of the company and on its behalf, binds the company, although they may not have acted in the manner prescribed by the regulations of the company."[3] But even this consideration is not steadily kept in view.[4]

§ 3970. View that Directors may do Whatever the Corporation may do. — Loose expressions are found in judicial opinions to the effect that the board of directors practically constitute the corporation, and in general may act as the corporation, and, unless specially restricted, exercise the cor-

[1] Thompson *v.* Wesleyan Newspaper Asso., 8 C. B. 849.

[2] Ernest *v.* Nicholls, 6 H. L. C. 401, 423. See also, Fountain *v.* Carmathew &c. R. Co., L. R. 5 Eq. 316. Occasionally, however, a more liberal interpretation of the powers and a less rigid construction of deeds of settlement prevails. Ex parte Overend Gurney & Co., L. R. 8 Eq. 14; Waterlow *v.* Sharp, L. R. 8 Eq. 501.

[3] *Ibid.* See Royal British Bank *v.* Turquand, 5 El. & Bl. 248; *s. c.* 6 El. & Bl. 327; Clarke *v.* Imperial Gas Co., 4 Barn. & Ad. 315; Hill *v.* Manchester &c. Co., 5 Barn. & Adol. 866; Smith *v.* Hull Gas Co., 11 C. B. 897; Agar *v.* Athenæum Life Soc., 3 C. B. (N. S.) 725; Prince of Wales Asso. Soc. *v.* Athenæum Ins. Soc., 3 C. B. (N. S.) 756, n.; Prince of Wales Asso. Soc. *v.* Harding, El., Bl. & El. 183; Anglo-Austrian &c. Asso. Co. *v.* British Provident &c. Soc., 3 Giff. 521; *s. c.* 4 De G. F. & G. 341; Ex parte Eagle Co., 4 Kay & J. 549; Webb *v.* Commrs., L. R. 5 Q. B. 642; Ex parte Overend Gurney & Co., L. R. 4 Ch. 460.

[4] Peirce *v.* Jersey Waterworks Co., L. R. 5 Exch. 209.

porate powers.[1] But this, in strictness, is only true of those corporations in which the board of trustees or directors are themselves incorporated and are the corporation,—which, we have already seen,[2] is often the case. In ordinary business corporations the powers of the board of directors, as we shall presently see, fall far short of being coequal with the powers of the corporation. It is hence better said that "the directors, in the absence of restrictions in the charter or by-laws, have *all the authority of the corporation itself in the conduct of its ordinary business*."[3]

§ **3971. But cannot do More.**—On the other hand, as said by Parker, C. J.: "The individual stockholder commits no authority to its officers, but that which is given by the charter of incorporation and by a vote of a major part in interest of the individuals acting in a corporate form."[4] It is perfectly clear that restrictions may be laid upon the authority of the directors in the *incorporating act*, not, it is conceived, by reason of

[1] Burrill *v.* Nahant Bank, 2 Met. (Mass.) 163; *s. c.* 35 Am. Dec. 395; Whitwell *v.* Warner, 20 Vt. 425; Union Turnpike Co. *v.* Jenkins, 1 Caines (N. Y.), 381; Leavitt *v.* Oxford &c. Silver Mining Co., 3 Utah, 265.

[2] *Ante*, § 16.

[3] Bank *v.* Rutland &c. R. Co., 30 Vt. 159, 169, *per* Redfield, C. J. See also Royalton *v.* Royalton &c. Turnp. Co., 14 Vt. 311; Stevens *v.* Davison, 18 Gratt. (Va.) 819; *s. c.* 98 Am. Dec. 692. In Re Bachman, 12 Nat. Bank. Reg. 223, it was held that a by-law which provided that no transfer of stock should be made or allowed, by any stockholder who at the time was indebted to the bank, could not be *waived* by the bank officers and directors. This conclusion was founded upon the theory that the capital stock of a corporation was a trust fund for the benefit of creditors of the corporation. See Wood *v.* Dummer, 3 Mason (U. S.), 308; *ante*, § 2951. The indebtedness in this case was an unpaid and uncalled for balance on the subscription to stock. The waiver of the by-law operated, therefore, to the prejudice of creditors.

[4] Wyman *v.* Hallowell &c. Bank, 14 Mass. 58, 63; *s. c.* 7 Am. Dec. 194. The same distinguished judge in a later case said: "The case of Wyman *v.* Hallowell &c. Bank recognizes a distinction between acts of an agent for his principal in common cases and similar acts done by the servants or officers of a corporation. And there is reason for this distinction; for, in the first case, the extent of the authority is known only between the principal and the agent; whereas, in the latter, the authority is created by statute, or is matter of record in the books of the corporation to which all may have access who have occasion to deal with the officers." Salem Bank *v.* Gloucester Bank, 17 Mass. 1, 29; *s. c.* 9 Am. Dec. 111.

the publicity of such limitation as assigned in the foregoing, but because the sovereign power, from which the life of the corporation emanates, may grant only such powers as are agreeable to its will, and likewise may, with unquestioned discretion, prescribe the manner in which such powers shall be exercised.[1]

§ 3972. Effect of By-laws Limiting their Powers.—When it is considered that the directors of a business corporation are merely the agents or trustees appointed by the stockholders to manage its business, it would seem to be clear that a general power to make *by-laws* conferred upon almost all corporations in their charters or governing statutes, and where not so conferred possessed as an *inherent power* under the principles of the common law,[2] enables the stockholders to establish by-laws *restraining* and *reducing* the powers which the directors may otherwise exercise in the management of the affairs of the corporation. We have had occasion to note decisions upholding the validity of such by-laws, as those prescribing what shall be a *quorum* of the board of directors where the charter or governing statute is silent.[3] And these merely serve to illustrate the fact that nearly all the by-laws established by the stockholders of corporations are intended to operate, and do operate, to restrain and regulate the powers of the directors. But the extent to which by-laws restraining the powers of directors will be binding upon *third persons* is a totally different question. It is essential to the safety of members of the public in dealing with private corporations, that they should be allowed to act upon the principle, in the absence of notice to the contrary, that the directors possess and are entitled to wield all the powers conferred upon the corporation, by its charter or governing statute, *in the conduct of its ordinary business*. From this the conclusion follows that a by-law restraining the powers of the directors will not be binding upon a third person dealing or contracting with the

[1] Head *v.* Providence Ins. Co., 2 Cranch (U. S.), 127.

[2] *Ante*, § 955.

[3] *Ante*, § 1049.

corporation, unless he is brought into *privity* with that by-law by *notice* of its existence in some form.[1]

§ **3973. Their Powers not Extended by By-laws.** — In general it may be stated that what the law prohibits to be done directly cannot be done indirectly. Directors cannot indirectly accomplish an object beyond the scope of their powers. For example, notwithstanding they may be authorized to *amend the by-laws* of the corporation, yet they have not the right so to amend them as to deprive the stockholders of those fundamental powers whereby they control the officers of the corporation. Elsewhere we have stated that the corporate powers, unless otherwise expressed, will be regarded as vested in the board of directors, who are quite beyond the control of the stockholders in their management of the affairs of the corporation. To amend the by-laws so as to extend their period of office is to deprive the stockholders of that supervision over the affairs of the corporation which the right of election gives.[2] Thus, where the power to *lay assessments* is vested in the corporation by statute, this power cannot, it has been held, be assumed even by the board of directors under any form of by-law whatever. A statute of Massachusetts enacted, in regard to manufacturing corporations,[3] "that any such corporation may from time to time, at any legal meeting called for that purpose, assess upon each share, such sum or sums of money as shall be judged by such corporation necessary for raising a capital for the establishment and completion of the object of the incorporation, and for defraying the charges and expenses incident thereto, to be paid to their treasurer, at such time or times and by such installments, as shall be directed by the corporation." The directors, acting under the authority of one of the by-laws of the corporation, which

[1] A pertinent illustration of this statement will be found in Union Mut. Fire Ins. Co. *v.* Keyser, 32 N. H. 313; *s. c.* 64 Am. Dec. 375. See, to the same effect, Campbell *v.* Merchants' Ins. Co., 37 N. H. 35, 41; *s. c.* 72 Am. Dec. 324; Sullivan *v.* Triunfo Gold &c. M. Co., 29 Cal. 585. See further, *ante*, § 942.

[2] Curtis *v.* McCullough, 3 Nev. 202.

[3] Stat. Mass. 1800, § 5.

declared that "they [the directors] shall take care of the interests and manage the concerns of the corporation,"—levied an assessment of ten per cent. Mr. Justice Story held that the policy of the statute was clear that the power in question should be lodged exclusively in the corporation, and was therefore incapable of delegation in the by-laws of the company; moreover, that the language of this by-law neither required nor admitted of an interpretation which should include any such delegation of authority.[1] The act creating a corporation will not be interpreted as contravening, repealing, or in any wise changing the fundamental law of the land. Therefore, although the act incorporating a *bank* confers upon the directors the power to make by-laws touching "the time, manner, and *terms*" upon which *discounts* shall be made, this authority can operate only upon the *internal conduct* of the business of the bank. It will not extend so far as to override a statute against usury.[2]

§ 3974. Authority within What Limits Supreme.—The management of the business of a business corporation is, unless otherwise expressed in its charter or by-laws, vested in the board of directors, and cannot be exercised by the stockholders; nor can the directors be overruled by the stockholders; nor have the stockholders the power to instruct them or to control their action.[3] The remedy of the stockholders consists in waiting till the time arrives for electing a new directory, and in then electing directors willing to manage the corporation in conformity with their views. Or, if the existing directors persist in a course of management which is tantamount to a breach of their trust, the stockholders may

[1] Ex parte Winsor, 3 Story (U. S.), 411. See also Marlborough Man. Co. *v.* Smith, 2 Conn. 579, 580. Compare *ante*, § 1705.

[2] Seneca County Bank *v.* Lamb, 26 Barb. (N. Y.) 595.

[3] See the remarks of Kennedy, J., in Dana *v.* Bank of United States, 5 Watts & S. (Pa.) 223, 246. See also Dayton &c. R. Co. *v.* Hatch, 1 Disney (Ohio), 84; Bank of Kentucky *v.* Schuylkill Bank, 1 Pars. Sel. Cas. Eq. 181; State *v.* Bank of Louisiana, 6 La. 745; Conro *v.* Port Henry Iron Co., 12 Barb. (N. Y.) 27. But see Scott *v.* Eagle Fire Co., 7 Paige (N.Y.), 198.

appeal to a court of equity, under principles hereafter considered.[1] In conformity with this principle, under a statute[2] providing that the business of every dividend-paying corporation "shall be managed by the directors thereof, subject to the by-laws and votes of the corporation, and under their direction by such officers and agents as shall be duly appointed by the directors or by the corporation," — it was held that the stockholders could not join another officer with the directors, nor compel the directors to act with one not a director.[3] So, it was obviously well held that a vote by the shareholders of a corporation, to issue bonds to purchase certain property and rights, is controlled by a resolution of the board of directors declining to carry out the arrangement, where the charter and by-laws give only the directors power to borrow.[4]

§ 3975. The Stockholders cannot Act for the Company. The stockholders as such in their collective capacity can do no business act; though they must act on all questions of *fundamental changes*, such as increasing or decreasing the capital.[5] All authority in respect of the business of the corporation is lodged in the board of directors. This is but an application of the general rule that the corporate concerns must be managed according to the manner prescribed in the act of incorporation, and where this provides, as is generally the case, for the election of a board of directors, for this purpose, no other mode of action can be entertained.[6] A court, therefore, will not act upon *alterations of the charter* proposed by individual members of the association in opposition to the governing board, nor even, upon the petition of the majority of such members, will it compel the body in whom the corporate powers are vested to *affix the seal* of the corporation to

[1] *Post*, § 4479, *et seq.*

[2] Gen. Stat. N. H., ch. 134, § 3.

[3] Charlestown Boot &c. Co. *v.* Dunsmore, 60 N. H. 85.

[4] Cann *v.* Eakins, 23 Nova Scotia, 475.

[5] *Ante*, § 2076; and the like. *Post*, §§ 3980, 3981.

[6] *Ante*, § 1075; McCullough *v.* Moss, 5 Denio (N. Y.), 567; Finley &c. Co. *v.* Kurtz, 34 Mich. 89; Union Gold Mining Co. *v.* Rocky Mt. Nat. Bank, 2 Col. 565.

measures, contrary to their own judgment.[1] The wishes of the majority are of no avail, unless expressed in valid form. Where the powers of a religious corporation were lodged in a council of seven members, and the members of the congregation unlawfully drove the members of the council from a meeting, and then passed a resolution *discontinuing a suit* which had been regularly instituted, this proceeding was held to be ineffectual for its purpose.[2] A promise to pay the president, directors, and company, upon demand, must be complied with upon the *demand of the president and directors*, where the incorporating act vests the latter with power to manage the concerns of the company. In such a case, not only is the demand of the president and directors sufficient, but any action by the company in a collective capacity would be nugatory.[3]

§ 3976. Exceptions and Qualifications of This Rule. — In certain *emergencies*, however, powers conferred upon the body of directors have been exercised by an assembled body of stockholders. Thus, the stockholders, having been lawfully convened to hold an election of directors, the inspectors appointed by the directors to supervise this election refused to act. The stockholders appointed new inspectors who conducted the election legally and fairly in all respects. This proceeding of the stockholders was justified. "Such an emergency and contingency had arisen that the ordinary forms of procedure prescribed and contemplated by the charter and laws regulating these elections had suddenly failed to accomplish the purposes contemplated by them."[4] Moreover, under all theories of joint-stock incorporation the stockholders are the ultimate constituency; and in many schemes of incorporation the directors cannot act upon certain subjects without the consent of the stockholders, or a

[1] Com. *v.* St. Mary's Church, 6 Serg. & R. (Pa.) 508.

[2] German Evang. Cong. *v.* Pressler, 14 La. An. 811.

[3] Union Turnpike Co. *v.* Jenkins, 1 Caines (N. Y.), 381, 391.

[4] *Per* Mason, J., Re Wheeler, 2 Abb. Pr. (N. S.) (N. Y.) 361, 364.

given proportion of them.[1] Moreover, formal action is often dispensed with, even in the most important matters, where all the members of the corporation, including the stockholders and the directors, are present, and concur, although there is no formal vote, either of the stockholders or of the directors. Such an informal concurrence has been held to validate a mortgage of the property of the corporation.[2] And so it has been held that a formal resolution at the stockholders' meeting, authorizing the president of the corporation to execute a deed conveying all the property of the corporation, is sufficient authority for such a conveyance.[3] And so, where, by the terms of the charter, the stockholders were constituted a body politic and corporate, with power to make by-laws touching all matters whatsoever which might pertain to the concerns of the company, and they made a by-law giving the board of directors the "whole charge and management of the property," and authorized it to delegate to an *executive committee* the power to do any acts which the board itself might do, and the board thereafter authorized the executive committee to exercise all the powers of the board when it was not in session, and the executive committee executed a contract letting another railroad into the joint use of a bridge, which contract was approved by the *stockholders* at a regular meeting, — it was held that this was binding on the company, though never ratified by a formal resolution of the board of directors; and that this was so, although five of the twenty

[1] *Post,* ch. 132. For instance, under the California Act of May 12, 1853, for the incorporation of turnpike road companies, a majority of the stockholders of such a company, assembled in stockholders' meeting, may authorize the board of directors to execute a promissory note of the company; and if a note is executed by a board of directors without such authority, a subsequent resolution adopted by a majority of the stockholders, levying an assessment to pay the note, is a *ratification,* and makes the note the note of the company. Forbes *v.* San Rafael Turnp. Co., 50 Cal. 340.

[2] Eureka Iron &c. Works *v.* Bresnahan, 60 Mich. 332.

[3] But it is to be noted that no board of directors had been elected for three years: Burr *v.* McDonald, 3 Gratt. (Va.) 215.

directors were appointed by the government of the United States, and not elected by the stockholders.[1]

§ **3977. Further of This Rule.**—Coming back to the strict rule, we find a learned opinion in which it is held that the stockholders of a corporation have no power as such to authorize the sale of the corporate property or to sell the same, either when collectively assembled in a stockholders' meeting or when acting individually; but that the power to sell and convey can be conferred only by the board of directors or trustees when assembled and acting as a board.[2] Returning to the looser but more practical conception, and one on which so many of the informal acts of corporations have been held valid on the theory of *ratification*,[3] or *estoppel*,[4] we find a holding to the effect that a conveyance authorized at a meeting, at which all the shareholders are present and sign a written consent to the proceedings on the record, pursuant to a statute,[5] is as effective as if authorized by the directors,—there being in fact but one beneficial stockholder and no board of directors.[6] This brings us again to the theory that the directors of such a corporation are merely a board of agents or trustees for the aggregate body of the stockholders, clothed with certain powers of ordinary business management; and that when it comes to the exercise of larger powers they must have the express assent of the stockholders or a subsequent ratification. This theory is illustrated by a case in which it was held that, as a general rule, the directors of a railroad company cannot

[1] Union Pacific R. Co. *v.* Chicago &c. R. Co., 51 Fed. Rep. 309; affirming *s. c.* 47 Fed. Rep. 15.

[2] Gashwiler *v.* Willis, 33 Cal. 11; *s. c.* 91 Am. Dec. 607.

[3] *Post*, § 5314.

[4] *Post*, § 5271.

[5] Rev. Stat. Mo. 1879, § 735, providing that when all the members of a corporation shall be present at any meeting, however called or notified, and shall sign a written consent thereto on the record of such meeting, the acts of such meeting shall be as valid as if legally called and notified.

[6] Manhattan Brass Co. *v.* Webster &c. Co., 37 Mo. App. 145. The sole stockholder transferred one share of stock each to two dummies to make up the three stockholders required to constitute a joint-stock corporation under the statutes of Missouri.

authorize, without the previous approval of the stockholders, the construction of a passenger station in a State other than that in which the railroad company was created, and at a point to which its line does not extend, and cannot embark the funds committed to their control and disposal in the payment and cost of such a building; but that circumstances may nevertheless exist where the construction of such a station will so increase the facilities of their own railroad, through a connecting line, as to justify them in making such an expenditure without taking the sense of the stockholders.[1]

§ 3978. Directors have no Common-law Powers. — The foregoing doctrine is involved in the cloudy conception that, in some way or other, directors have common-law powers. But, however it may be in England, it may be doubted whether there are any common-law corporations in the United States. All the corporations with which we are dealing in this work — and all of which we have knowledge, — are created by or under acts of the Legislature of the United States or of some of the States or Territories. Their directors exercise merely *granted powers*, — that is to say, powers granted either by the governing statute, or by the members in the form of articles of association, by-laws, or other constating instruments. It is therefore well said in other cases that the directors of a corporation are but agents of the corporation, and can only act for or bind it within such limits, and in such ways, as the charter or by-laws, or some act of the members, authorize.[2] This is quite incompatible with the conception that they possess a body of powers derived from the common law. At the same time it is to be kept in view that the courts, through their habit of

[1] Nashua &c. R. Corp. *v.* Boston &c. R. Corp., 136 U. S. 356, 384. Circumstances and charter amendments under which the directors of a railroad company may act in changing the line, without consent of the stockholders: Stewart *v.* Little Miami R. Co., 14 Ohio, 353.

[2] Salem Bank *v.* Gloucester Bank, 17 Mass. 1, 29; *s. c.* 9 Am. Dec. 111; Bank of Kentucky *v.* Schuylkill Bank, 1 Pars. Sel. Cas. 180; Ridley *v.* Plymouth Grinding &c. Co., 2 Ex. 711; Royalton *v.* Royalton &c. Co., 14 Vt. 311.

taking judicial notice of the usages of business, and of drawing general conclusions and deducing general rules from frequently recurring facts, ascribe certain powers to the various officers of corporations, under the name of *implied powers.* But this implication is in the nature of a rebuttable presumption, and it is generally open to show that, in the particular case, such powers have not, in fact, been granted. Another meaning of this is that third persons, in dealing with corporations, are entitled to presume that certain of their officers possess certain usual and customary powers, and may safely act on that presumption unless the corporation gives them to understand the contrary. Moreover, all that is said in this section must be taken subject to the qualification that where the principles of the common law ascribe certain powers *to corporations*, as inherent powers to be exercised *in the course of their business*, — such we will say as the power to contract debts and issue the usual securities therefor, — those powers are presumptively lodged in the directors without any express grant, and the public may safely act on that presumption in the absence of a restraining statute, or in the absence of notice of a restraint imposed by a valid by-law or other governing instrument.

§ **3979. No Power to Make Constituent Changes.** — It has already been pointed out,[1] that the board of directors occupy towards the corporation a position similar to that which the Legislature occupies towards the State. The Legislature cannot change the constitution, for it has been created by higher authority than the Legislature; nor can it make any fundamental change in the government of the State. In like manner, the board of directors are agents or trustees, with the limited power of directing the affairs of the corporation, under and subject to the constitution which has been provided for their guidance, namely, the corporate charter. They can make no fundamental changes which they are not authorized to make by that instrument, nor by the members of the cor-

[1] *Ante*, § 2076.

poration, in a mode provided for by that instrument. They can make no change with reference to the nominal capital of the company,[1] nor to its membership, without the consent of the stockholders; for this would have the effect of making the stockholders members of a different corporation from that which they consented to join. It would be a breach of the organic compact which the members have made with each other. "It would change the relative influence, control, and profit of each member. If the directors alone could do it, they could always perpetuate their own power. Their agency does not extend to such an act, unless so expressed in the charter."[2] The fact that the charter in terms allows the corporation at its pleasure to increase its capital stock from time to time, and vests *all the powers* of the corporation in the board of directors, has been held not to change this rule.[3] For the same reasons, the directors have no power to *reduce* the capital of the corporation of which they are the governing body.[4] But according to some opinions, they may, in the absence of statutory provision, direct a *purchase by the corporation of its own stock,* and may hold it unextinguished and reissue the same.[5] Neither can they, in corporations organized under a principle other than that of having a joint stock, *admit new members,* unless the power to do so is expressly conferred.[6] So, in those corporations where the offices involve a *franchise,* the directors or trustees have no power of *amotion:* that resides alone in the corporation.[7] Nor can they, according to the

[1] *Ibid.*

[2] Railway Co. *v.* Allerton, 18 Wall. (U. S.) 233; Gill *v.* Balis, 72 Mo. 424, 433.

[3] Railway Co. *v.* Allerton, 18 Wall. (U. S.) 233. See also Heath *v.* Erie R. Co., 8 Blatch. (U. S.) 347. That such an increase may be validated by the *acquiescence* of the shareholders, see *ante,* § 2083.

[4] Percy *v.* Millaudon, 3 La. 568; Hartridge *v.* Rockwell, R. M. Charlt. (Ga.) 260; *ante,* § 2076.

[5] City Bank *v.* Bruce, 17 N. Y. 507; Taylor *v.* Miami Exporting Co., 6 Ohio, 176, 218. But see *ante,* § 2057.

[6] Thus, under the 4th and 5th sections of the act incorporating the Philadelphia Savings Institution, the directors had not the power to elect members, but only to provide for their election. Com. *v.* Gill, 3 Whart. (Pa.) 228.

[7] Power of amotion (including that of suspension) cannot be delegated to a board of directors. State *v.* Chamber of Commerce, 20 Wis. 68; *ante,* § 804.

prevailing view, make *by-laws* for the government of the corporation, unless expressly empowered so to do.[1] But in Pennsylvania, where the courts go far in sanctioning the power of the Legislature to alter corporate charters against the will of the minority,[2] it has been held that the Legislature may confer *enlarged powers* upon the managers of a corporation *with the assent* of the *majority of the shareholders*, and that no one stockholder, by refusing his assent, can hinder their exercise. Thus, the directors of a corporation, authorized by an act of the Legislature, which the stockholders have accepted, may issue *preferred stock*, notwithstanding the opposition of individual shareholders.[3]

§ **3980. Cannot Apply for or Accept Amendment of Charter.**—The charter of the corporation constituting the contract between the corporation and the stockholders, the directors have no power to change it without the consent of the stockholders.[4] Thus, the general power given by the charter of a manufacturing company to the directors to manage the stock, property, and affairs of the corporation, does not enable them to apply to the Legislature for an enlargement of the company's powers. Such an application can be made by authority of the company only.[5] And a resolve of the Legislature, passed on such application without authority from the company, giving power to the company to raise an additional assessment on the stockholders, for the purpose of paying the debts, is inoperative.[6] So, it has been well held that the president and directors of a banking company cannot accept an amended charter, the result of which would be to deprive certain stockholders in the company of their rights as such.[7]

[1] *Ante*, § 956.

[2] *Ante*, § 960.

[3] Curry *v.* Scott, 54 Pa. St. 270.

[4] Stark *v.* Burke, 9 La. An. 341; *ante*, § 86, *et seq.*

[5] Marlborough Man. Co. *v.* Smith, 2 Conn. 579, 580; Zabriskie *v.* Hackensack &c. R. Co., 18 N. J. Eq. 178; *s. c.* 90 Am. Dec. 617; State *v.* Adams, 44 Mo. 570.

[6] Marlborough Man. Co. *v.* Smith, 2 Conn. 579.

[7] Boisdere *v.* Citizens' Bank, 9 La. 506; *s. c.* 29 Am. Dec. 453. But, contrary to this, it was held by the Superior Court of Cincinnati that the

§ 3981. Nor Accomplish this Result by Indirect Means. — Nor can directors be permitted to accomplish, by indirect means, what they are forbidden to do directly.[1] Thus, where a statute provides that corporations may *increase their capital stock* by vote of the stockholders at a meeting called for that purpose,[2] it is not within the implied powers of any corporate officer to bind the corporation to an increase of the capital stock by an agreement with an employé to pay for his services in stock of the corporation when none remains unissued.[3] A sale of stock, however, by a corporation, if otherwise valid, will not be vitiated by the fact that the motive of some of the directors and of the purchaser was to enable the latter to vote on the stock in a certain manner at an approaching election of directors.[4] This is true also in the case of the purchase by the corporation of its own stock.[5] But directors have no right to make certificates purporting to represent capital stock which has not in fact been subscribed and paid for, and put them on the market as stock, and sell them below par.[6] Nor, as a part of a fraudulent device to increase the stock, can they, in pursuance of statutory authority, issue bonds of the corporation convertible into stock. To justify the exercise of the authority in question, the money raised from the issue of these bonds must be needed and applied to the purposes authorized by the statute.[7] Neither can it be tolerated that the *negligence* or *fraud* of the agent of the corporation

acceptance of an amendment to its charter is a power incident to a corporation, which may be exercised by a board of directors, if there is *no other active governing body* in whom it is vested. Dayton &c. R. Co. *v.* Hatch, 1 Disney (Ohio), 84. This point is believed not to have been well decided.

[1] State *v.* McCullough, 3 Nev. 202, 225.

[2] Comp. L. Mich. 1871, § 2841.

[3] Finley &c. Co. *v.* Kurtz, 34 Mich. 89.

[4] State *v.* Smith, 48 Vt. 266; Hartridge *v.* Rockwell, R. M. Charlt. (Ga.) 260.

[5] Taylor *v.* Miami Exporting Co., 6 Ohio, 176. But see *ante*, § 2054.

[6] Fisk *v.* Chicago &c. R. Co., 53 Barb. 513; *s. c.* 36 How. Pr. (N. Y.) 20. See, also, Sturges *v.* Stetson, 3 Phila. (Pa.) 304. Compare *ante*, § 2105, *et seq.*

[7] Belmont *v.* Erie R. Co., 52 Barb. (N. Y.) 637. See N. Y. Sess. Laws 1850, ch. 140, § 28, subsec. 10. Sturges *v.* Stetson, *supra*.

appointed to issue its shares shall, in making an issue beyond the maximum limit, work the same result. Such *overissues* are void;[1] but the company may, none the less, be liable in damages to persons injured by the wrongful act of its agent.[2]

§ 3982. Cannot Make, Alter, or Annul By-laws. — As already seen, the general rule is that the directors of a corporation cannot make *by-laws* for its government unless empowered to do so by statute,[3] though numerous statutes have been enacted clothing them with this power.[4] But where the directors have the power to make and enforce a particular rule or regulation, such a regulation is not, of course, invalid from the mere circumstance that it is called a *by-law*, and that no power to make by-laws has been expressly given by the charter. It was so held where the directors of a merchants' exchange, having the express power to control the rooms of the exchange, established a by-law regulating the use of the same.[5] It has been held that a power, delegated by the charter of an incorporated merchants' exchange to the board of directors, to control the exchange rooms, and to "establish and enforce such rules and regulations in regard to the use of the same, as may seem proper," empowers such board to enact a by-law declaring the exchange rooms open for business during certain hours daily, and prohibiting smoking therein during such hours, notwithstanding that the board thereby extends the hours designated for such purposes by by-laws already adopted by the corporation.[6]

[1] New York &c. R. Co. *v.* Schuyler, 38 Barb. (N. Y.) 534; *ante*, § 1492.

[2] *Ante*, § 1493.

[3] *Ante*, § 956.

[4] *Ante*, § 962, *et seq.*

[5] Albers *v.* Merchants' Exchange, 39 Mo. App. 583.

[6] Albers *v.* Merchants' Exchange, 39 Mo. App. 583. In addition to what has already been said upon this subject (*ante*, § 1036), a decision may be noted to the effect that a by-law of a corporation empowering the board of directors to impose fines on members, but prescribing no limit in regard to the extent or amount of such fines, is invalid, and that a by-law of a corporation, providing that a member of the corporation might be fined, censured, suspended, or expelled for disorderly or improper conduct, as the board of directors should determine,

§ 3983. May not Sell Out Corporate Assets and Business.—The directors of a corporation being its agents or trustees for the purpose of carrying on its business, and promoting the ends designed by its charter, they obviously have no power, without a strict authorization from their stockholders, to determine its business and defeat the objects of its charter, by selling out, *en masse*, its corporate assets and good-will;[1] unless the charter, by express terms or necessary implication, confers this power upon them.[2] In the view of one court, they cannot, unless specially empowered, make sale of *any portion* of its estate, essentially necessary for the transaction of its customary business.[3] They have no power to *lease* its property for 999 years without the assent of its stockholders.[4] And where they have the power, under a simple trust, to sell or lease the works of the company, they cannot, in the lease, give an *option* to the lessee, *to purchase*, or not, at a price fixed, the *entire works* of the company at any time within twenty years. Such a contract must be ratified by every member of the company, to become binding upon them.[5] So, it was held that the trustees of a company which had been organized, and which had provided very extensive shops and machinery, for the sole purpose of manufacturing hard rubber under certain patents which it owned, had no power to sell all the patent rights, all the personal property, machinery, stock on hand, and contracts, and lease the real estate.[6] But the

does not authorize such board to suspend a member for the non-payment of a fine, imposed on him for the violation of the corporate rules, when such member in good faith contests the validity of the fine. Albers *v.* Merchants' Exchange, 39 Mo. App. 583.

[1] Railway Co. *v.* Allerton, 18 Wall. (U. S.) 233, 235; Colman *v.* Eastern Counties R. Co., 10 Beav. 1; *s. c.* 4 Eng. Rail. Cas. 513; Abbot *v.* American Hard Rubber Co., 33 Barb. (N.Y.) 578; *s. c.* 21 How. Pr. (N. Y.) 193; Rollins *v.* Clay, 33 Me. 132.

[2] As was the case with the charter of the St. Louis Gaslight Company. St. Louis *v.* St. Louis Gaslight Co, 70 Mo. 69, 98.

[3] Rollins *v.* Clay, 33 Me. 132.

[4] Metropolitan Elevated Ry. Co. *v.* Manhattan Elevated Ry. Co., 11 Daly (N. Y.) 373; *s. c.* 14 Abb. N. Cas. (N. Y.) 103.

[5] Clay *v.* Rufford, 19 Eng. L. & Eq. 350; *s. c.* 5 De Gex & S. 768.

[6] Abbot *v.* American &c. Co., 33 Barb. (N. Y.) 578.

rule here stated is not inflexible. One decision, at least, qualifies it by holding that when the affairs of the corporation are in a condition so desperate as to preclude the possibility of continuing the business of the corporation, the board of directors are confronted with a new duty, that of discharging the liabilities of the corporation, and that, for this purpose, they may sell the property of the corporation.[1] So, it has been held that the transfer, by trustees of a corporation, of all its property to another corporation, made in good faith to prevent the total loss of the property, which transfer was authorized and ratified by a large majority of the stockholders, will not subject such trustees to an action by a dissenting stockholder.[2]

§ 3984. But may Alien Corporate Real Estate in Course of Business.—But this is not at all incompatible with an implication of power in directors to alien the real estate of the corporation in the ordinary course of its business.[3] Thus, it has been held that a statutory power in the directors of a *railroad company* to transact all the business of the company, and to sell and convey real property, with a right to complete portions of the road, and to elect between routes and *termini*, authorizes them to sell a portion of the right of way, in satisfaction of a mortgage debt; and that the mortgagee will not afterwards be allowed to treat the contract as *ultra vires* and proceed to foreclose his mortgage, even though he still holds the bonds to secure which it was given; but the company is entitled to have them canceled.[4] So, where the by-laws of a corporation provided that the directors should have, in the management of the affairs of the corporation, all the powers which the corporation itself possessed, not incompatible with the provisions of the by-laws and the laws of the Commonwealth, it was held that they might *mortgage* the lands of the

[1] Ashurst's Appeal, 60 Pa. St. 290, 313. See, also, Sheldon Hat Blocking Co. v. Eickmeyer Hat Blocking Co, 56 How. Pr. (N. Y.) 70.

[2] People v. Ballard, 3 N. Y. Supp. 845.

[3] See a valuable note on this subject in 59 Am. Rep. 466.

[4] Donner v. Dayton &c. R. Co., 1 Cinc. (Ohio) 130.

corporation in security for its *bonds,* where the by-laws permitted it to done.[1] But it has been held that authority given a *single director* to *make contracts* for the sale of the lands of a corporation does not empower them to *convey* them.[2]

§ **3985. May Mortgage Corporate Property.**—In general, it may be stated that, as an incident to the authority of the directors to contract debts and obligations in the course of the ordinary business of the corporation, they have authority to *pledge* and *convey* the real or personal estate of the corporation as security for the payment of the same.[3] It cannot be doubted, where the by-laws of a corporation provide that in the management of its affairs the directors shall have all the powers which the corporation itself possesses, not incompatible with the by-laws and the laws of the State, and there is nothing in the by-laws incompatible with the exercise by the directors of the power to *borrow money, issue bonds,* or to convey in *mortgage* the lands of the corporation as security, that the directors may exercise such power.[4]

§ **3986. May Assign for Benefit of Creditors.** — There is much authority for the view that the directors of an insolvent corporation may, without the consent of the stockholders, make an assignment in good faith of all its assets to a trustee for the payment of its creditors;[5] though, as the exercise of this power generally has the effect of putting an end to the

[1] Hendee *v.* Pinkerton, 14 Allen (Mass.), 381. Compare Tyrrell *v.* Washburn, 6 Allen (Mass.), 466.

[2] Green *v.* Hugo, 81 Tex. 452; *s. c.* 26 Am. St. Rep. 824; 17 S. W. Rep. 79.

[3] Sargent *v.* Webster, 13 Met. (Mass.) 497, 503; *s. c.* 46 Am. Dec. 743; Burrill *v.* Nahant Bank, 2 Met. (Mass.) 163; *s. c.* 35 Am. Dec. 395; Despatch Line *v.* Bellamy Man. Co., 12 N. H. 205, 224; *s. c.* 37 Am. Dec. 203; Miller *v.* Rutland &c. Co., 36 Vt. 452; Augusta Bank *v.* Hamblet, 35 Me. 491; Jackson *v.* Brown, 5 Wend. (N. Y.) 590; Hoyt *v.* Thompson, 19 N. Y. 207; Gordon *v.* Preston, 1 Watts (Pa.), 385; *s. c.* 26 Am. Dec. 75; Bank Commissioners *v.* Bank of Brest, Har. Ch. (Mich.) 106; *post,* ch. 133.

[4] Hendee *v.* Pinkerton, 14 Allen (Mass.), 381.

[5] Merrick *v.* Trustees &c., 8 Gill (Md.), 59. See *post,* chs. 145, 146, where this subject is fully dealt with, including the inquiry, whether the directors can make *preferential assignments,* and whether they can *prefer themselves.*

corporation,[1] its existence is denied by some courts.[2] And clearly the directors have no such power where the governing *statute* prescribes a different mode for winding up the affairs of the corporation and liquidating its debts. The statutory mode is *exclusive*. The reason is that the statute forms a part of the security to the public, and one of the conditions upon which corporations subject thereto take their chartered powers.[3]

§ **3987. When Assign to Other Trustees.** — There may be circumstances which will warrant the transfer of the corporate property, or portions of it, by the directors, *to trustees*, for purposes which are lawful and consistent with their duty to the corporation.[4] But such a transfer will be subjected to rigid scrutiny, because it puts the title to the property beyond the proper control of the board of directors, who are by law, trustees for the control and management of the property for the benefit of the stockholders, and subjects it to the control of another class of trustees, making "the actual benefits to be derived by the stockholders depend upon the efficiency of proceedings in court to compel performance of such a trust."[5]

§ **3988. May Borrow Money.** — A general power granted to the directors to manage the affairs of the corporation includes, according to the American view,[6] the power to *borrow money* when necessary in the course of its business. Thus, it has been held that a board of *bank* directors, authorized to conduct the affairs of the company, may empower the president, or the president and cashier, to *borrow money*, *indorse* its *notes*, or to obtain a *discount* for the use of the

[1] *Ante*, §§ 3345, 3347.

[2] Gibson *v.* Goldthwaite, 7 Ala. 281; *s. c.* 42 Am. Dec. 592; *post*, ch. 153.

[3] Bank Commissioners *v.* Bank of Brest, Har. Ch. (Mich.) 106.

[4] Ashurst's Appeal, 60 Pa. St. 290, 312.

[5] Ogden *v.* Murray, 39 N. Y. 202.

[6] See *ante*, § 3985. The English rule is the contrary: Burmester *v.* Norris, 6 Ex. 796; Chambers *v.* Manchester &c. R. Co., 33 L. J. (N. S.) 238.

bank.[1] So, the directors of a *manufacturing corporation*, formed under a general statute giving them authority to manage its concerns, have power to make an advance in the payment of wages to its *agent;* and for this purpose they may empower him to use the company's credit.[2] The authority granted to incorporated banks by the general banking laws of New York, must, it has been held, be exercised by the directors, who were mere agents for the shareholders, and who were to exercise their powers for the benefit of the shareholders, within the legitimate business of banking. If this power were improperly exercised, the shareholders, and others interested in the bank, would not be liable to the lenders of money.[3] A general power in the directors to borrow money for the use of the corporation includes the power to *secure the debt* thus created, in any appropriate mode, as by assigning bonds and mortgages owned by the corporation,[4] and by *mortgaging* corporate property.[5] Where a general power on the part of the directors to borrow for the corporation thus exists, one who lends money to it upon their application in good faith will not be charged with knowledge of or responsibility for any breach of trust on their part in the application of it to the use of the corporation.[6] Nor will the corporation be allowed, while keeping the money, to set up a want of power on the part of its directors to borrow it, or that it was, after being borrowed, put to unauthorized uses.[7]

§ 3989. May Make and Transfer Negotiable Paper. — The power to borrow includes, by a natural implication, the power to emit those *evidences of indebtedness* which are *cus-*

[1] Fleckner *v.* Bank of United States, 8 Wheat. (U. S.) 338; Ridgway *v.* Farmers' Bank of Bucks County, 12 Serg. & R. (Pa.) 256; *s. c.* 14 Am. Dec. 681; Merrick *v.* Bank of Metropolis, 8 Gill (Md.), 59.

[2] Tripp *v.* Swanzey Paper Co., 13 Pick. (Mass.) 291.

[3] Leavitt *v.* Yates, 4 Edw. Ch. (N. Y.) 134.

[4] North Hudson Mut. &c. Asso. *v.* First Nat. Bank, 79 Wis. 31; *s. c.* 11 L. R. A. 845; 47 N. W. Rep. 300.

[5] *Post*, ch. 133.

[6] North Hudson Mut. &c. Asso. *v.* First Nat. Bank, *supra;* Borland *v.* Haven, 37 Fed. Rep. 394.

[7] North Hudson Mut. &c. Asso. *v.* First Nat. Bank, 79 Wis. 31; *s. c.* 11 L. R. A. 845; 47 N. W. Rep. 300.

tomary in the business world.[1] It is therefore stated with confidence, as the general American doctrine, that the directors of any business or financial corporation have the power to make, accept, or assign negotiable paper in the course of the business of the corporation.[2] The directors of a *manufacturing corporation* do not, for instance, exceed their powers by authorizing their agent to raise money for his own use and give therefor the company's note.[3] So, a board of trustees of a society for the erection of a monument, under an authority "to manage the finances and property of the society," by necessary implication, have power, through their treasurer, to bind the society by a promissory note and such other obligations as are usually resorted to in managing the finances of such institutions.[4] So, a note belonging to a bank may be assigned or transferred by its directors, who have the control of its financial affairs.[5] So, bank directors, having authority to control all the property of the bank, may *authorize one of their number* to *assign* any *securities* belonging to the corporation; and a *blank indorsement*, in pursuance of such authority, by the persons so authorized, is sufficient to transfer a note; and the indorsement may be properly filed at the bar.[6] But clearly a *single director* is not authorized, as such, without special authority, to make notes binding the corporation.[7]

§ 3990. May Assume or Guarantee Debts of Other Persons or Corporations, when. — The directors of a *railroad company* acting under a statute of Ohio authorizing railroad companies to aid each other, for the purpose of making connections, by subscriptions to the capital stock *or otherwise*,

[1] *Post*, § 5731; ch. 131, art. I.

[2] *Post*, § 5731.

[3] Tripp *v.* Swanzey Paper Co., 13 Pick. (Mass.) 291, 293. Here again the *English* is contrary to the American law: *Post*, § 5735; Dickinson *v.* Valpy, 10 Barn. & C. 128; *s. c.* 5 Man. & Ryl. 126; Harmer *v.* Steele, 4 Ex. 1; *s. c.* 19 L. J. (N. S.) 34. Compare Thompson *v.* Wesleyan Newspaper Associations, 8 C. B. 849; *s. c.* 19 L. J. (N. S.) 114.

[4] Hayward *v.* Pilgrim Soc., 21 Pick. (Mass.) 270. See also, First Baptist Church *v.* Caughey, 85 Pa. St. 271.

[5] Stevens *v.* Hill, 29 Me. 133.

[6] Northampton Bank *v.* Pepoon, 11 Mass. 288.

[7] Lawrence *v.* Gebhard, 41 Barb. (N. Y.) 575; *ante*, § 3906.

indorsed a *guaranty upon bonds* of another company to a large amount, which were held valid, after approval of such action by the stockholders, although the statute declared that no aid should be furnished until voted by two-thirds of the stockholders at a meeting called by the directors.[1] The directors of a company will be justified in assuming the debt of a third person only in the event of urgent necessity, although the company has received a consideration therefor by way of extension of its own credit at the hands of the common creditor;[2] the general rule being that a *corporation has no power* to become *guarantor, surety,* or accommodation indorser for another.[3]

§ 3991. May Fix the Salaries of Corporate Officers.— Directors who have the power of appointing corporate officers, may, in the absence of any prohibition in the by-laws, fix the salaries of such officers. This power is regarded as incidental to the power of appointment, and to the general powers and duties of directors.[4] But this is subject to limitations hereafter pointed out.[5]

§ 3992. May not Fix Price of Shares of Stock.—The price at which shares of stock shall be issued is not a matter within the discretion of the directors. This is defined by the charter, the governing statute or articles of association under which the corporation comes into existence; and in the absence of any explicit direction, the just implication is, that they can only dispose of the shares at their par value in "money or money's worth."[6] Therefore, directors have no power to issue shares below par, although the incorporating act declares that the directors may determine "the times and terms of payment of stock." This being so, directors cannot indirectly accomplish the unlawful object; as where they executed a bond to a stockbroker for a sum largely in excess of

[1] Zabriskie *v.* Cleveland &c. R. Co., 23 How. (U. S.) 381.

[2] Stark Bank *v.* United States Pottery Co., 34 Vt. 144.

[3] *Post,* § 5721.

[4] Waite *v.* Windham Mining Co., 37 Vt. 608.

[5] *Post,* §§ 4682, 4706, *et seq.*

[6] *Ante,* § 1563, *et seq.* Compare *ante,* § 1665, *et seq.*

the consideration thereof, and permitted the obligee to convert his bond into stock to the value of the sum named therein.[1]

§ 3993. Powers in Levying Assessments. — Where the number of shares is fixed in the charter of a corporation or in its articles of association, the directors have no power to levy an assessment before the whole number shall have been subscribed.[2] Up to this time the corporation cannot be said to have had a legal existence. The directors, therefore, can do only such acts as are necessary to set the association in motion as a corporation. They have no power to make contracts and incur liabilities in the furtherance of the corporate enterprise.[3]

§ 3994. When Release Corporate Interest. — The directors of a *bank*, having care of the financial affairs of the bank, have power to direct the prosecution or defense of suits involving its interests, and therefore possess all the powers incidental thereto: for example, before the statutes admitting interested parties to testify became general, to execute a *release* to a person whom they propose to call as a *witness*.[4] They may direct an *assignment or transfer* of a *note* belonging to the bank; and, having this power, there is no reason why it should not be exercised by one of their body, with the consent of the rest expressed by their vote.[5] The assent of a

[1] Sturges *v.* Stetson, 3 Phila. (Pa.) 304. See, also, Fisk *v.* Chicago &c. R. Co., 53 Barb. 513; *s. c.* 36 How. Pr. (N. Y.) 20.

[2] Stoneham Branch R. Co. *v.* Gould, 2 Gray (Mass.), 277; Salem Mill Dam Corp. *v.* Ropes, 6 Pick. (Mass.) 23; *s. c.* 9 Pick. (Mass.) 187; 19 Am. Dec. 363; Central Turnp. Corp. *v.* Valentine, 10 Pick. (Mass.) 142, 143; Lexington &c. R. Co. *v.* Chandler, 13 Met. (Mass.) 311; Worcester &c. R. Co. *v.* Hinds, 8 Cush. (Mass.) 110; Cabot &c. Bridge *v.* Chapin, 6 Cush. (Mass.) 50; New Hampshire &c. R. Co. *v.* Johnson, 30 N. H. 390; *s. c.* 64 Am. Dec. 300; Allman *v.* Havana &c. R. Co., 88 Ill. 521; *ante*, § 1235, *et seq.*

[3] Salem Mill Dam Corp. *v.* Ropes, 6 Pick. (Mass.) 23, 40; Allman *v.* Havana &c. R. Co., 88 Ill. 521.

[4] Lewis *v.* Eastern Bank, 32 Me. 90.

[5] Northampton Bank *v.* Pepoon, 11 Mass. 288; Spear *v.* Ladd, 11 Mass. 94; Stevens *v.* Hill, 29 Me. 133; Cooper *v.* Curtis, 30 Me. 488; Merrick *v.* Bank of Metropolis, 8 Gill (Md.), 59.

bank that a note may be sued in its name, for the benefit of a third person, may be inferred from the acts of its officers, without any vote of the directors on the subject.[1]

§ **3995. Cannot Give Away its Assets.** — The office of directors is to *manage* and not to *give away* the assets of the corporation. They have no power, by giving away its funds, to deprive it of any of the means to accomplish the purposes for which it was chartered.[2] They cannot, as just seen,[3] dispose of its stock at a less price than that fixed by the governing instrument, and generally at no less than par.[4] They cannot use the funds of the company in purchasing the shares of its members, thereby distributing its tangible assets among its members and advancing its insolvency and dissolution.[5]

§ **3996. But may Make Bona Fide Compromises.** — But they may, in the exercise of their best judgment, make *bona fide compromises with shareholders*[6] or others, of disputed claims, and settle pending actions.[7]

§ **3997. And Conduct Corporate, but not Private, Litigation at Corporate Expense.** — Undoubtedly the board of directors or trustees of a corporation may, unless restrained by some governing instrument, prosecute or defend any litigation of the corporation at the corporate expense;[8] but they cannot fritter away its funds in litigation in respect of their own individual rights in the corporation.[9] To prosecute and defend actions for the corporation is not only a *power*, but a *duty* of the directors; and if they fail or refuse to perform it, the stockholders will be allowed, in equity, to do so, under

[1] Lime Rock Bank *v.* Macomber, 29 Me. 564.

[2] Bedford R. Co. *v.* Bowser, 48 Pa. St. 29; Frankfort Bank *v.* Johnson, 24 Me. 490.

[3] *Ante*, §§ 3992, 1563.

[4] Sturges *v.* Stetson, 3 Phil. (Pa.) 304; *s. c.* 1 Biss. (U. S.) 246.

[5] Bedford R. Co. *v.* Bowser, 48 Pa. St. 29. See also, Penobscot &c. R. Co. *v.* Dunn, 39 Me. 587; Ex parte Bennett, 5 De Gex, M. & G. 284; 24 L. J. (N. S.) 130; *post*, § 4035.

[6] *Ante*, § 1553.

[7] Donahoe *v.* Mariposa Land &c. Co., 66 Cal. 317.

[8] *Post*, ch. 177, art. II.

[9] Harbison *v.* First Presbyterian Soc., 46 Conn. 529; *s. c.* 33 Am. Rep. 34.

conditions hereafter stated.[1] A *contumacious resignation* by officers of a company cannot prevent the company from filing a petition in *bankruptcy*, if a majority of shareholders authorize it to be done.[2]

§ 3998. Powers of Directors of Banking Companies. — As already seen,[3] according to an early theory, the *directors* of a banking corporation *alone* have power to make discounts and fix any conditions which may be proper in loaning money.[4] But it is believed that this power is now usually exercised, not by the full board, but by committees, and that this delegation of it will, under most governing instruments, be upheld as valid.[5] Indeed, in many cases this power is actually performed by the president and cashier, or either. They generally *elect the cashier*, and appoint ministerial officers and agents, and control their actions, except where duties are enjoined upon them by the governing instrument or by the statute law, — which we shall see is sometimes the case.[6] They have authority to make a settlement with the cashier, whose accounts exhibit a deficit, and their fraud in such a settlement will not avoid it unless participated in by him.[7] A verbal direction from them to the cashier, without any recorded vote of the board, is a sufficient authority to guide him in the application of moneys officially received by him.[8] Directors may, it has been held, in the exercise of their discretion, anticipate payments of debts, although such debts

[1] *Post*, § 4119.

[2] Davis *v.* Railroad Co., 1 Woods (U. S.), 661.

[3] *Ante*, § 3948.

[4] Bank of United States *v.* Dunn, 6 Pet. (U. S.) 51; *s. p.* New York Bank Commrs. *v.* Bank of Buffalo, 6 Paige (N. Y.), 497.

[5] *Ante*, § 3948.

[6] *Post*, § 4739, *et seq.* Where a surrender of a bank charter had been accepted by the Legislature, but the corporate existence of the bank was continued for a limited time, to enable it to close its affairs, — it was held under the general banking law of Maine, that the directors might legally elect a cashier. Cooper *v.* Curtis, 30 Me. 488.

[7] Frankfort Bank *v.* Johnson, 24 Me. 490.

[8] Stamford Bank *v.* Benedict, 15 Conn. 437.

bear a high rate of interest, if the money is needed for the legitimate business of the bank.[1]

§ **3999. Effect of Ultra Vires Acts of Directors.**—The subject of the effect of the *ultra vires* acts of directors is a very extensive one and is reserved for separate treatment.[2] The general proposition which is here affirmed is that such acts do not bind the corporation or the stockholders, unless *ratified*, or unless circumstances of *equitable estoppel* exist. In what is perhaps the leading English case on the subject, it was ruled by the highest judicatory of that country that where the directors of a company do acts in violation of their deed of settlement in a matter in which they have no authority, their acts are altogether null and void. But when acts to be done are within the power and duty of the directors, and are neglected, and thereby third parties are damaged, neither a court of law nor of equity will allow the company to take advantage of that neglect.[3] If the thing done by the directors is not only *ultra vires*, but *prohibited* by positive law, no one participating in it with knowledge can acquire any rights in respect of it. Thus, one who, with knowledge, advances money to the directors of a mining company to enable them to declare a fictitious dividend in the face of a prohibitory statute, can have no remedy against the company for such advance.[4] The doctrine of *ultra vires* in respect of corporations has had, and is still having, an evolution. No one can state with confidence what the law on that subject is at the present time, still less predict what it will be in the near future. The doctrine of one of the earlier English cases, that the directors of a railway company have no right to enter into, or to pledge the funds of the company in support of any project not pointed out by their act, although such project may tend to increase the traffic upon the railway, and may be assented to by the majority of the shareholders, and the object

[1] Keyser *v.* Hiltz, 2 Mackey (D. C.), 513.

[2] *Post*, § 5967, *et seq.*

[3] Bargate *v.* Shortridge, 5 H. L. Cas. 297; *s. c.* 31 Eng. L. & Eq. 44.

[4] Davis *v.* Flagstaff Silver Mining Co., 2 Utah, 74.

of such project may not be against public policy, may readily be conceded; but the further declaration of the same case that the *acquiescence* by the shareholders in a project for ever so long time, affords no presumption of its legality,[1]—is certainly not now, if it ever was, the law.[2]

§ **4000. Loss of Power by Lapse of Time.**—Where express power has been conferred upon the governing body of a corporation by the corporation to do an act, it may become an interesting question whether the power to do the act named, in the absence of an express limitation in point of time, will be lost by the lapse of a considerable period of time. The question was passed upon in a case in Massachusetts, under the following facts: The trustees of a society, which had been created for the purpose of *building a monument* to commemorate the virtues of the Pilgrim Fathers, had voted that their treasurer might give a note to one of their number who had paid a debt due from the society, without limiting the time within which the authority was to be exercised. It was held that the treasurer might make the note *several years afterwards*, the claim not being barred by the *statute of limitations;* though it was conceded that, had the debt been barred by the statute of limitations, a different question would have been presented.[3]

§ **4001. Instances of their Ordinary Contracting Powers.** The directors of a corporation have a general power to make and modify its contracts, and its stockholders cannot control that power when it is exercised in good faith.[4] Under antiquated judicial conceptions, they might contract under the corporate seal for payment of money in furtherance of the business of the corporation. They need not sign their names to such contract, but their doing so would not vitiate the corporate act.[5] According to another old and weak con-

[1] Colman *v.* Eastern Counties Railway Co., 4 Eng. Rail. Cas. 513.

[2] *Post,* § 5314.

[3] Hayward *v.* Pilgrim Soc., 21 Pick. (Mass.) 270, 296. A *misrecital* in such note, that it was given in pursuance of a vote of the society, instead of a vote of the trustees, was deemed immaterial. *Ibid.*

[4] Flagg *v.* Manhattan Ry. Co., 20 Blatchf. (U. S.) 142.

[5] Clark *v.* Farmers' Woollen Man. Co., 15 Wend. (N. Y.) 256. See also M'Donough *v.* Templeman, 1 Har. & J. (Md.) 156; *s. c.* 2 Am. Dec. 510.

ception, they may authorize stockholders to pay debts due from them to the corporation, by transferring stock in the corporation; and a transfer of stock accordingly will discharge the debt.[1] But the circumstances under which a corporation may take its own stock in payment of its ordinary debts are believed to be much more limited than would seem from this decision.[2] While they may not give away the assets of the company,[3] they may do the next thing to it, by *reviving debts* barred by limitation.[4] So, the board of trustees of a charitable corporation, to whom has been committed general financial powers, may lawfully change the liability of the society by creating one debt to pay another, whenever in their opinion it becomes necessary or expedient.[5] As the trustees of a *charitable corporation* are trustees in equity, in a sense which does not entirely hold good in respect of the directors of business corporations, this decision would rather involve the question of the power of a trustee to *vary the securities* of which the trust fund consists. That the directors of a business corporation may, in the absence of a positive restraint, do this, admits of no question. The trustees of a *secret society*, vested with general power to manage its property, may *lease the lodge-room* to another society for one night in each week.[6] The directors of a corporation may act *in another State* in or about any matter which pertains to their powers as *agents* of the corporation, and which is not a constituent or corporate act, — such as to give *notes* and *mortgages* to secure the same.[7]

§ **4002. Powers under Particular Instruments.** — A stockholders' resolution that "it is not deemed necessary to adopt by-laws, for the reason that the articles of incorporation provide that the control and management of the corporation shall be in the hands of the board of directors," has been held to leave the entire control of the corporate business with the directory.[8] The subscribers'

[1] Taylor *v.* Miami Exporting Co., 6 Ohio, 176, 218.

[2] See *ante*, § 2054, *et seq.*

[3] *Ante*, §§ 1521, 3995.

[4] Directors of a corporation, authorized to bind it by a contract and note, may include in the note items of account which otherwise would be barred by the statute of limitations, were the corporation sued on them. Leavitt *v.* Oxford &c. Silver Mining Co., 3 Utah, 265.

[5] Hayward *v.* Pilgrim Soc., 21 Pick. (Mass.) 270.

[6] Phillip *v.* Aurora Lodge, 87 Ind. 505.

[7] Reichwald *v.* Commercial Hotel Co., 106 Ill. 439. Validity and effect of contract to issue *stock* to a *railroad contractor:* Savage *v.* Ball, 17 N. J. Eq. 142.

[8] Reichwald *v.* Commercial Hotel Co., 106 Ill. 439.

agreement of a provisionally registered company authorized the directors to adopt all such measures as they should in their judgment consider necessary or expedient for the promotion of a certain undertaking. It was held that a resolution of the directors, enabling any three of them to draw checks on the funds of the company, was within this power, and that when the three directors drew a check, under the authority given by that resolution, and applied the money improperly, those directors, who were not privy to such drawing or application, were not liable.[1]

§ 4003. Their Contracts not Voidable because of Errors of Judgment. — The contracts of directors and other officers of corporations will not be set aside in equity, as being in breach of their official trust, because of mere errors of judgment. This rule was applied so as to deny the cancellation of a railway lease at the suit of the lessee where its directors had agreed to pay a larger rent than the business of the leased road justified, although a minority of the directors and stockholders in the lessee company were stockholders in the lessor company, and were in that way personally interested in the contract against their own company, — where, on the whole evidence, it appeared that the excessive rent agreed to be paid was due to an honest error as to what was best for the interest of both roads.[2] Upon the same principle, an agreement by the officers of a corporation, presumably with the sanction of the directors, to pay a third party $5,000 in shares of the company's stock, for procuring for it a loan of $15,000 to help it through an emergency, and to pay, for procuring the loan of a smaller sum, a proportionate amount of such shares, has been upheld.[3]

[1] Ex parte Johnson, 31 Eng. L. & Eq. 430. The powers and duties of the board of directors, under the Pennsylvania Act of March 17, 1869, which confers upon railroad companies the power to widen their roadway whenever in the opinion of the board of directors such widening may be necessary, defined. Lodge *v.* Railroad Co., 1 Leg. Gaz. Rep. (Pa.) 131. Construction of a contract between two railroad corporations for the joint management of their lines, including certain lines leased to them with reference to the powers of their respective boards: Nashua &c. R. Co. *v.* Boston &c. R. Co., 27 Fed. Rep. 821.

[2] Jesup *v.* Illinois &c. R. Co., 43 Fed. Rep. 483.

[3] Arapahoe Cattle &c. Co. *v.* Stevens, 13 Col. 534; *s. c.* 22 Pac. Rep. 823.

CHAPTER LXXVIII.

OBLIGATIONS OF DIRECTORS AS FIDUCIARIES.

ART. I. IN GENERAL. §§ 4009–4053.
II. CONTRACTS BETWEEN THE DIRECTORS AND THE CORPORATION. §§ 4059–4075.
III. CONTRACTS BETWEEN TWO CORPORATIONS HAVING THE SAME DIRECTORS. §§ 4079–4087.

ARTICLE I. IN GENERAL.

SECTION
4009. Directors are trustees for the stockholders.
4010. Bound to exercise their powers for the benefit of the company.
4011. Cannot create any relation which will make their personal interests antagonistic to those of the corporation.
4012. Illustrations.
4013. Engaging in a rival business.
4014. No power to give away the assets of the company.
4015. Paying claims barred by limitation.
4016. Bound to act with the utmost good faith.
4017. Engagements contrary to their duty voidable.
4018. Illustrations.
4019. Personally liable for *ultra vires* acts.
4020. To what extent trustees for the public.
4021. To what extent trustees for creditors.
4022. Not allowed to make a profit out of their trust.
4023. Personally liable for breaches of their trust.
4024. Must account to the company for secret profits.
4025. Rule not applicable to dealings open and acquiesced in.
4026. Rule subject to the maxim that he who seeks equity must do equity.
4027. Must account for bribes given to influence their official action.
4028. Not chargeable with profits made by a third party out of their trust relation.
4029. Illustrations showing liability to account for secret profits.
4030. Further illustrations.
4031. Illustrations continued.
4032. Continued.
4033. Cannot buy shares from the company and resell at a profit.
4034. But may purchase the shares of other stockholders.
4035. But not with the funds of the company.
4036. Purchasing property from themselves for the company.

SECTION
4037. Buying property for themselves and reselling to the corporation at a profit.
4038. Liable for colluding with promoters.
4039. The same subject continued.
4040. Cannot buy up claims against the company at a discount and prove them for the full amount.
4041. View that they may recover the amount expended in such purchases.
4042. Cannot vote upon question affecting his private interest.
4043. Cannot deal for themselves with the corporate property.
4044. Illustrations.

SECTION
4045. Cannot conduct their private litigation at corporate expense.
4046. Ratification of such contracts by the shareholders.
4047. What will amount to a ratification.
4048. What will not amount to a ratification.
4049. View that corporation cannot condone fraud of officer except by unanimous consent.
4050. Rights of third persons in cases of such breaches of trust.
4051. Measure of liability for such breaches of trust.
4052. All directors liable who fraudulently conspire.
4053. Liability of promoters to account for secret profits.

§ **4009. Directors are Trustees for the Stockholders.**— The directors or trustees, by whatever name called, of a corporation, are the agents selected by the stockholders or members,generally from their own number, to manage the ordinary affairs of the corporation, in the exercise of their best discretion, subject to the charter or governing statute, and to the by-laws, rules, and regulations prescribed by the stockholders. Such being their *status*, they occupy a *fiduciary relation* towards the stockholders, and are treated by courts of equity as *trustees* for them.[1] Chancellor Walworth said, in a frequently cited

[1] Verplanck *v.* Mercantile Ins. Co., 1 Edw. Ch. (N. Y.) 84; *s. c.* 2 Paige (N. Y.), 438; Attorney-General *v.* Utica Ins. Co., 2 Johns. Ch. (N. Y.) 371, 385; Cunningham *v.* Pell, 5 Paige (N. Y.), 607; Lane *v.* Bank, 9 Heisk. (Tenn.) 419; Cook *v.* Berlin Mill Co., 43 Wis. 433; Robertson *v.* Bullion, 11 N. Y. 243; Bliss *v.* Matteson, 45 N. Y. 22; *s. c.* 52 Barb. (N. Y.) 335; Scott *v.* Depeyster, 1 Edw. Ch. (N. Y.) 513; Simons *v.* Vulcan Oil and Mining Co., 61 Pa. St. 202, 221; *s. c.* 100 Am. Dec. 628; Bradbury *v.* Barnes, 19 Cal. 120; Hale *v.* Republican River Bridge Co., 8 Kan. 466; Chouteau *v.* Allen, 70 Mo. 290; Benson *v.* Heathorn, 1 Younge & C. 326; Aberdeen R. Co. *v.* Blakie, 1 Macq. H. L. 461; *s. c.* 26 Scot. Jur. 628; 1 Paterson Sc. App. 391; Great Luxembourg R. Co. *v.* Magnay, 25 Beav. 586; Imperial Mercantile Credit Asso. *v.* Coleman, L. R. 6 H. L. 189; Albion Steel &c. Co. *v.* Martin, 1 Ch. Div. 580; Bennett's Case, 5 De Gex, M. & G. 284; Ex parte Bennett. 18

case:[1] "Since the introduction of joint-stock corporations, which are mere partnerships, except in form, the principles which were formerly applied to charitable corporations in England may be very appropriately extended to such companies here. The directors are the trustees or managing partners, and the stockholders are the *cestuis que trust*, and have a joint interest in all the property and effects of the corporation.[2] And no injury the stockholders may sustain by a fraudulent breach of trust can, upon the general principles of equity, be suffered to pass without a remedy."[3] It is sometimes said that they are trustees *for the corporation;*[4] but it must be remembered that we are now dealing with a doctrine of courts of equity, which looks through the form and into the substance of things, and hence it is more accurate to regard them as trustees for the body of shareholders, by whom they are elected, than to regard them as trustees for the artificial body, which really consists of its shareholders, *only* when acting within their powers through the board of directors. It is also frequently said that they are trustees and *agents* of the shareholders;[5] but this statement does not vary the principle that they are trustees for the shareholders; for they are certainly not agents for the shareholders in the sense which enables the shareholders to instruct them or to control them in the performance of their duties;[6] though, according to some conceptions, they are agents *of the corporation*,[7] while, according to others, they are the corporation itself. It must be kept in mind that we

Beav. 339; Ernest *v.* Croysdill, 2 De Gex, F. & J. 175; Re Anglo-Greek Steam Nav. Co., 35 Beav. 399; Williams *v.* Page, 34 Beav. 661; Karnes *v.* Rochester &c. R. Co., 4 Abb. Pr. N. S. (N. Y.) 107, 111; Butts *v.* Wood, 38 Barb. (N. Y.) 181; *s. c.* affirmed, 37 N. Y. 317; Corbett *v.* Woodward, 5 Sawyer (U. S.), 403; Koehler *v.* Black River &c. R. Co., 2 Black (U. S.), 715; York &c. R. Co. *v.* Hudson, 16 Beav. 495; *s. c.* 22 L. J. (N. S.) 529; 19 Eng. L. & Eq. 361. See also note, 98 Am. Dec. 102, and other cases there cited.

[1] Robinson *v.* Smith, 3 Paige (N.Y.), 222; *s. c.* 24 Am. Dec. 212.

[2] Citing 1 Wood's Inst. 110; 11 Coke, 98 b.

[3] Citing the language of Lord Hardwicke in Charitable Corp. *v.* Sutton, 2 Atk. 400, 406.

[4] Parsons *v.* Hayes, 14 Abb. N. C. (N. Y.) 419, 430.

[5] Cumberland Coal & Iron Co. *v.* Parish, 42 Md. 598.

[6] *Ante*, § 3969.

[7] *Ibid.*

are now dealing with the question in respect of the rights of *shareholders* and not in respect of the rights of creditors. Although, as already pointed out,[1] the capital stock of a corporation is a *trust fund* in equity for its creditors and shareholders, yet this does not make the directors trustees for the creditors in a technical sense, while the corporation continues a going concern. Until insolvency exists or is foreseen, they have no relation towards creditors except as agents of the corporation acting for their own principal.[2]

§ **4010. Bound to Exercise Their Powers for the Benefit of the Company.** — The duty of the governing board of a corporation is to conserve its property and further the interests and objects of the association. Any action on the part of the directors looking to the impairment of corporate rights, the sacrifice of corporate interests, the retardation of the objects of the corporation, and *a fortiori*, the destruction of the corporation itself, will be regarded as a flagrant breach of trust on the part of directors engaged therein.[3] "Directors and officers of corporations occupy a position of trust, and must act in the utmost good faith. They will not be allowed to deal with the corporate funds and property for their private gain. They have no right to deal for themselves and for the corporation at the same time, and they must account for the profits made by the

[1] *Ante*, § 2951.

[2] Briggs *v.* Spaulding, 141 U. S. 132.

[3] Ward *v.* Society of Attorneys, 1 Coll. Ch. 370; Bank Commissioners *v.* Bank of Brest, Har. Ch. (Mich.) 106; Smith *v.* Smith, 3 Desaus. Eq. (S. C.) 557; Abbot *v.* American Hard Rubber Co., 33 Barb. (N. Y.) 578; Conro *v.* Port Henry Iron Co., 12 Barb. (N. Y.) 27, 64; Ward *v.* Sea Ins. Co., 7 Paige (N. Y.), 294; Brouwer *v.* Hill, 1 Sandf. (N. Y.) 629; Brouwer *v.* Appleby, 1 Sandf. (N. Y.) 158; Bedford R. Co. *v.* Bowser, 48 Pa. St. 29; Hart *v.* Brockway, 57 Mich. 189; Paine *v.* Irwin, 59 How. Pr. (N. Y.) 316; Hilles *v.* Parish, 14 N. J. Eq. 380; Sheldon Hat Blocking Co. *v.* Eickmeyer Hat Blocking Co., 56 How. Pr. (N. Y.) 70; Smith *v.* New York Consolidated Stage Co., 18 Abb. Pr. (N. Y.) 419; Copeland *v.* Citizens' Gas. Co., 61 Barb. (N. Y.) 60; Frothingham *v.* Barney, 6 Hun (N. Y.), 366; Taylor *v.* Earle, 8 Hun (N. Y.), 17; Gray *v.* New York &c. Steam Co., 3 Hun (N. Y.), 383; Peabody *v.* Flint, 6 Allen (Mass.), 52; Gross *v.* Sackett, 2 Bosw. (N. Y.) 617; Re Lady Byran Co., 1 Sawyer (U. S.), 349; Stevens *v.* Willard, 43 Vt. 692; Wright *v.* Oroville Mining Co., 40 Cal. 20; State *v.* Citizens' Savings Bank, 31 La. An. 836.

use of the company's assets and for moneys made by a breach of trust."[1] Therefore, where the articles of association gave the directors power to receive payment of calls in advance, the directors of the company paid into the bank, in which the company kept its account, the amount remaining uncalled on their shares, and on the same day appropriated the money in the payment of their fees, for the payment of which they knew there was at the time no available assets, this, it was held by Vice-Chancellor Bacon, was not a *bona fide* payment in anticipation of calls, but a simulated transaction by which the directors, knowing the company to be insolvent, and unable to pay them their fees, sought to set off such fees against their liability as subscribers for shares, and thereby get rid of their liability as shareholders. They were therefore held liable upon their shares as though no such payment had been made.[2] The directors of a bank, which belonged entirely to the State, had power, under the charter of the bank, to appoint officers on whom they could devolve extra duties, and to allow them such compensation as was reasonable and just. This did not empower them to perform such duties by a committee of their own members, and for money so disbursed they were personally liable to the bank in *assumpsit*.[3]

§ 4011. Cannot Create Any Relation Which will Make their Personal Interests Antagonistic to Those of the Corporation.—The trust relation held by a director does not admit of his creating any relation between himself and the trust property which will make his interest antagonistic to that of his beneficiary.[4] This principle obtains whether the director is considered as a *trustee* or an agent; for a confidential agent cannot create relations which place him in hostility to his

[1] Ward *v.* Davidson, 89 Mo. 445, 458, *per* Black, J.; Wardell *v.* Railroad Co., 103 U. S. 651.

[2] Sykes's case, L. R. 13 Eq. 255.

[3] Branch Bank *v.* Collins, 7 Ala. 95.

[4] Brewster *v.* Stratman, 4 Mo. App. 41; Attaway *v.* Third Nat. Bank, 93 Mo. 485, 492; reversing *s. c.* 15 Mo. App. 578. As to the effect of directors becoming interested adversely to the corporation, see Cook *v.* Sherman, 20 Fed. Rep. 167, where there is an extensive note.

principal.[1] Upon this principle it has been held that the treasurer of a company cannot buy up a claim against it, and then maintain an action against a director, upon a statute, for improperly consenting to the declaration of a dividend.[2] Thus, it has been held that a *ship's husband*, being a servant of the ship-owners, holding an important office and open to the vigilant superintendence of his employers, it is presumptively a breach of trust in any director of a company established for the purpose of acquiring and working vessels, especially where the directors have the exclusive management of the concern, to take upon himself the duties of a ship's husband. When, therefore, in a company so constituted, one of the directors, with the consent of others forming with himself a board of directors, undertook the office of ship's husband, and in that character received out of the funds of the company such sums for commission and brokerage as are usually allowed to a ship's husband,—it was held that he must refund those moneys. And it seems the other members of the board of directors would be similarly responsible, in the event of any inability in the principal party implicated, to refund.[3] But the principle must be applied within reasonable limits. Thus, the fact that one is the *president* of a corporation does not prevent him from doing that which the corporation has lost the ability to do, even if continued in existence.[4]

§ **4012. Illustrations.**—Thus, for directors, who are creditors also of the corporation, to raise money by a mortgage of the corporate property for the purpose of paying off their own claims, without provision for the discharge of others, is to secure an advantage not common to all the stockholders, and therefore a plain breach of trust.[5] And so it is for the directors of a railroad corporation to

[1] Galbraith *v.* Elder, 8 Watts (Pa.), 81, 93; Whalley *v.* Whalley, 1 Vern. 484; Van Horne *v.* Fonda, 5 Johns. Ch. (N. Y.) 388, 407; Keller *v.* Leib, 1 Penr. & W. (Pa.) 220, 223.

[2] Hill *v.* Frazier, 22 Pa. St. 320.

[3] Benson *v.* Heathorn, 1 Younge & C. 326.

[4] Murray *v.* Vanderbilt, 39 Barb. (N. Y.) 140. And see Hannerty *v.* Standard Theatre Co., 109 Mo. 297; *s. c.* 19 S. W. Rep. 82.

[5] Koehler *v.* Black River Falls Iron Co., 3 Black (U. S.), 715. See, also, Stratton *v.* Allen, 16 N. J. Eq. 229; Van Hook *v.* Somerville Man.

engage in a scheme for the sale of the road with its franchises, rolling stock, etc., under a decree of foreclosure at a price far below their value, for the purpose of relieving themselves from liability on indorsements made for the company, or for the purpose of becoming possessed of the property themselves.[1] When it becomes necessary to sell the corporate property, it is the duty of the directors, to the extent of their power, to secure for all those whose interests are in charge, bondholders as well as stockholders, the highest possible price obtainable at such sale.[2] So, where the president of a packet corporation tried to procure mail contracts for it, but was unsuccessful, it was held that his relations to the corporation did not preclude his procuring the contracts for himself, but that he could not, in carrying them out, profit by the use of the facilities afforded by the packets of the corporation.[3]

§ **4013. Engaging in a Rival Business.** — There is judicial authority to the effect that it is not a breach of trust for the directors of a corporation to engage on their own account in the same business carried on by the corporation; and that, in respect of such private business, they do not stand in any sense in a trust relation to the corporation.[4] Another court, while conceding that the principle under consideration does not prohibit a director or officer of a corporation from engaging in a rival business, yet holds that the business, if so engaged in by him, is affected with a trust in behalf of his corporation, to the extent that he is bound to resort for carrying it on to all the facilities afforded by his corporation.[5] The former of these cases presented a state of facts where a *stockholder* in a manufacturing corporation began the erection of independent works for the same manufacture, and was joined in the enterprise by a *director*, and afterwards a *consolidation* was effected between their plant and that of the corpo-

Co., 5 N. J. Eq. 137; Bennett's case, 5 De Gex, M. & G. 284; Farmers' &c. Bank *v.* Downey, 53 Cal. 466; *s. c.* 31 Am. Rep. 62. Compare Smith *v.* Lansing, 22 N. Y. 520; Buell *v.* Buckingham, 16 Iowa, 284; *s. c.* 85 Am. Dec. 516.

[1] Drury *v.* Cross, 7 Wall. (U. S.) 299.

[2] Jackson *v.* Ludeling, 21 Wall. (U. S.) 616; *post*, § 4071.

[3] Keokuk &c. Packet Co. *v.* Davidson, 95 Mo. 467.

[4] Barr *v.* Pittsburgh Plate Glass Co., 51 Fed. Rep. 33.

[5] Keokuk &c. Packet Co. *v.* Davidson, 95 Mo. 467.

ration, by an unanimous vote of the stockholders of the latter; and where the court, finding that the director had acted in entire good faith, held that neither the corporation nor a stockholder therein had any standing in equity to procure relief against the arrangement.[1]

§ 4014. No Power to Give Away the Assets of the Company.—It is the duty of the directors and other officers of a corporation to preserve its property as a trust fund of which they are the guardians, and to administer it for the purposes of the trust. They have no right to divide the corporate property among themselves, or give it away without consideration.[2] Directors have no power to single out some of the *subscribers* to stock nor *release* them from their liability; such conduct was characterized by Strong, J., as "an abuse of their trust, wholly unauthorized and at war with the design of the charter."[3] Likewise, it is a fraud on the part of the directors of a bank to allow stockholders to withdraw its funds to the amount of their subscriptions and use them, without security, in their respective private businesses.[4] The same may be said of secret arrangements among the directors, by which the amounts due by one or more of them, on account of his subscription to the capital stock of the company, is canceled and discharged. While such arrangements do not have the effect of releasing the particular directors,[5] yet if the company actually sustains loss in consequence of them, the directors will be held bound to make good the loss.[6] The same rule has been applied where directors of an abortive company attempted to indemnify the shareholders by paying them back their

[1] Barr *v.* Pittsburgh Plate Glass Co., *supra.* The facts of the latter case are stated *post,* § 4030.

[2] St. Louis Stoneware Co. *v.* Partridge, 8 Mo. App. 580.

[3] Bedford R. Co. *v.* Bowser, 48 Pa. St. 29, 37; Burke *v.* Smith, 16 Wall. (U. S.) 390; Penobscot &c. R. Co. *v.* Dunn, 39 Me. 587; Walton *v.* Hake, 9 Mo. App. 596.

[4] Bank of St. Mary's *v.* St. John, 25 Ala. 566.

[5] *Ante,* § 1512, *et seq.*

[6] Hodgkinson *v.* National Live Stock Insurance Co., 26 Beav. 473; Bank of St. Mary's *v.* St. John, 25 Ala. 566, 612.

deposits.[1] Directors of *banks* have no power to sanction *overdrafts*, neither constructively, as where a usage and custom to overdraw is proven, nor explicitly by any vote, however formal.[2] Such an act is in violation of their duty, and in fraud of the rights and interest of stockholders. In a case of this kind, Mr. Justice Story said: "However broad and general the powers of the directors may be, for the government and management of the concerns of the bank, by the general language of the charter and by-laws, those powers are not unlimited, but must receive a rational exposition. It cannot be pretended that the board could, by a vote, authorize the cashier to plunder the funds of the bank, or to cheat the stockholders of their interest therein. No vote could authorize the directors to divide among themselves the capital stock, or justify the officers of the bank in an avowed embezzlement of its funds."[3]

§ **4015. Paying Claims Barred by Limitation.** — Trustees of a *religious* corporation are not permitted to allow claims against the corporation which are barred by the statute of limitations. "Consent of the officers of a company against the interests of the company may generally be set down as in favor of their own interests."[4] It would seem that a resolution of a board of trustees, signed by the chairman, would be sufficient to revive against the company a debt barred by limitations; yet, it seems that the acknowledgment would be vitiated if the resolution were passed at a board meeting at which the creditor was himself present in his character of director,[5]

[1] Williams *v.* Page, 24 Beav. 654. See, also, Clement *v.* Bowes, 1 Drew. 684.

[2] Minor *v.* Mechanics' Bank, 1 Pet. (U. S.) 46, 72; Market Street Bank *v.* Stumpe, 2 Mo. App. 545. Notwithstanding these judicial declarations, the practice of allowing solvent customers to overdraw their accounts is believed to be universal among American bankers. Indeed, in the daily business of depositing and checking, occasional overdrafts are unavoidable.

[3] Minor *v.* Mechanics' Bank, 1 Pet. (U. S.) 46, 71.

[4] Re Orthodox &c. Church, 6 Abb. N. C. (N. Y.) 398, 406. Compare Chapin *v.* Thompson, 4 Hun (N. Y.), 779; Lowndes *v.* Garnet &c. Mining Co., 33 L. J. Ch. 418; Koehler *v.* Black River Falls Co., 2 Black (U.S.), 715.

[5] Lowndes *v.* Garnet &c. Mining Co., 33 L. J. Ch. 418.

at least if his vote was necessary to the result.[1] It is a principle that, as between a principal and an indemnitor, in a case of general indemnity against claims or suits, a judgment against the principal is no more than *prima facie* evidence against an indemnitor; and that, in a suit upon the contract of indemnity, the indemnitor may show that his principal had a good defense to the original action which he neglected or refused to interpose, or that there was collusion between the plaintiff and the defendant in such original action; and if either of these defenses are established by the indemnitor, it will defeat a recovery against him.[2] Within the meaning of this rule, the defense that the claim is barred by limitation is deemed to be such a defense as the principal is bound to set up in order to charge the indemnitor; for it is settled that the defense of the statute of limitations stands upon the same footing with other legal defenses, and is to be treated by the courts with the same respect and given the same consideration as common-law defenses.[3]

§ 4016. Bound to Act with the Utmost Good Faith.— As directors are generally mandataries *without compensation*, other than that which, in common with the other shareholders, they derive from the proper management of the affairs of the company, they are not held to the exercise of more than *ordinary care;*[4] but they are bound to exercise their powers for the benefit of all the stockholders and *with the utmost good faith.* Nothing short of the *uberrima fides* of the civil law satisfies the requirements of their position. This rule is of equal application to the directors and the *other officers* of the corporation. They must not, in any degree, allow their official conduct to be swayed by their private interest, unless that interest is the interest which they have in the good of

[1] *Post*, §§ 4065, 4683.

[2] Chapin *v.* Thompson, 4 Hun (N. Y.), 779, 782; Bridgeport Fire Ins. Co. *v.* Wilson, 34 N. Y. 275; Annett *v.* Terry, 35 N. Y. 256; Binsse *v.* Wood, 37 N. Y. 526, 531.

[3] Chapin *v.* Thompson, 4 Hun (N.Y.), 779, 782.

[4] *Post*, § 4104.

the company in common with all the other shareholders. This principle is asserted and illustrated by judicial decisions almost without number.[1] This duty results from the nature of their employment, and without any stipulation to that effect.[2] Their private interest must yield to their official duty whenever those interests are conflicting.[3] They must neither exercise their trust for their own private exclusive benefit, nor for the benefit of *third persons.* They cannot, on the one hand, give away the property of the corporation,[4] or release its securities;[5] nor, on the other, take to themselves advantages not common to all the stockholders. And any arrangement by them with a contractor with the corporation by which they are to share in the profits of the contract must be *confirmed* by the stockholders.[6] And where a director, by means of his power as such, secures to himself any advantage over other stockholders or creditors, equity will treat the transaction as void, or charge him as trustee for the benefit of the injured parties; nor can such director, as to such parties, claim to have acted in *ignorance* of what it was his duty to know concerning the conduct and condition of the affairs of the corporation.[7] And an agreement of a director to use his vote and influence to the disadvantage of the corporation, and in the interest and for the benefit of *third persons,* is an immoral and corrupt agreement, and will not be enforced.[8] Being the agents of the corporation, if they exercise their functions for the purpose of injuring its interests and alienating its property, they are *personally liable* for loss occasioned

[1] Bestor *v.* Wathen, 60 Ill. 138; Leavitt *v.* Yates, 4 Edw. Ch. (N. Y.) 134; Blake *v.* Buffalo Creek R. Co., 56 N. Y. 485; Koehler *v.* Black River &c. Co., 2 Black (U. S.), 715; Perry *v.* Tuscaloosa Cotton-Seed Oil Mill Co., 93 Ala. 364; *s. c.* 9 South. Rep. 217; Blair Town Lot &c. *v.* Walker, 50 Iowa, 376.

[2] Benson *v.* Heathorn, 1 Younge & C. Ch. 326; Cumberland Coal &c. Co. *v.* Parish, 42 Md. 598.

[3] Ex parte Bennett, 18 Beav. 339.

[4] Union Bank *v.* Jones, 4 La. An. 236; *ante,* §§ 3995, 4014.

[5] Gallery *v.* National Exch. Bank, 41 Mich. 169; *s. c.* 32 Am. Rep. 149.

[6] Paine *v.* Lake Erie &c. R. Co., 31 Ind. 283; *post,* § 4025.

[7] Corbett *v.* Woodward, 5 Sawyer (U. S.), 403.

[8] Attaway *v.* Third Nat. Bank, 93 Mo. 485; 5 S. W. Rep. 16; 2 Rail. & Corp. L. J. 275.

thereby;[1] and being trustees of the corporate assets for its shareholders, whenever they have to divide those assets among the shareholders, they must give to each his proportionate share.[2] It seems scarcely necessary to add a holding to the effect that a resolution of the shareholders placing shares of their corporate property at the disposal of the directors, does not mean, at their disposal for *their personal benefit*, but it means at their disposal for the benefit of the company; and they must hence *account*, as trustees, for their administration of such property.[3]

§ 4017. Engagements Contrary to their Duty Voidable. — An engagement by a person who is a director, or other officer of a corporation, by which he agrees to do a thing which is, or may become, injurious to the stockholders, or to a majority of them, is an engagement contrary to the duty involved in his trust, and is voidable.[4]

§ 4018. Illustrations. — The *Standard Oil Company* desiring to buy up all the property of a partnership engaged in the business of refining petroleum, and thereby get the competition of such partnership out of the way, organized a company for that purpose, called the Baltimore United Oil Company, and subscribed for most of its stock through one C. as its trustee. In order to induce the partners to agree to the sale, C. entered into a personal contract with one of them, engaging that the latter should be permanently retained as vice-president of the new corporation at a salary of $5,000 per year. The plaintiff was kept in this position as long as it suited the Standard Oil Company, and then he was kicked out. It was held that he could not recover, in an action against C., for

[1] Attorney-General *v.* Wilson, 1 Craig & Ph. 1; *s. c.* 10 L. J. (N. S.) 53; 4 Jur. 1174.

[2] Hale *v.* Republican &c. Bridge Co., 8 Kan. 466.

[3] York &c. R. Co. *v.* Hudson, 19 Eng. L. & Eq. 361; *s. c.* 16 Beav. 495; 22 L. J. (N. S.) 529.

[4] Fuller *v.* Dame, 18 Pick. (Mass.) 472; Guernsey *v.* Cook, 120 Mass. 501; Wardell *v.* Railroad Co., 103 U. S. 651; Woodstock Iron Co. *v.* Richmond &c. Extension Co., 129 U. S. 643; Woodworth *v.* Wentworth, 133 Mass. 309; Bliss *v.* Matteson, 45 N. Y. 22; West *v.* Camden, 135 U. S. 507; Attaway *v.* Third National Bank, 93 Mo. 485; Davis *v.* Gemmell, 70 Md. 356; *s. c.* 17 Atl. Rep. 259.

damages for the breach of the covenant of C., since the contract was against public policy, and void within the foregoing rule.[1] An agreement, made by a majority of the directors of a corporation, among themselves, privately and unofficially, that they should be paid a percentage upon all the money raised upon the credit of a bond of indemnity, signed by them, against the future indebtedness of the corporation, is not binding on the corporation.[2] A director of an association, who had given to it an ordinary bond and mortgage for a loan, was not allowed to set up, as a defense to its foreclosure, that, by a secret parol agreement between him and the other directors, the loan had been repaid by his stock in the association having been fully paid up.[3]

§ 4019. Personally Liable for Ultra Vires Acts.—If the directors of a company do an act which is clearly beyond their power, whereby loss happens to the company, a court of equity will, in a proper proceeding, compel them to make good such loss out of their private estates.[4] The principle is said to be that if directors of a limited company apply the money of the company for purposes so outside its powers that the company could not sanction such application, they may be made personally liable as for a breach of trust; but if they apply the money of the company, or exercise any of its powers, in a manner which is not *ultra vires*, then a strong and clear case of misfeasance must be made out to render them liable for a loss thereby occasioned to the company.[5] For instance, if the trustees of a *religious corporation*, without authority, *change the securities* of a trust fund from those authorized by law to those unauthorized by law, they make themselves personally responsible for any loss sustained thereby, no matter

[1] West *v.* Camden, 135 U. S. 507.

[2] Butler *v.* Cornwall Iron Co., 22 Conn. 335.

[3] Pangborn *v.* Citizens' Building Asso., 35 N. J. Eq. 341.

[4] Joint Stock Discount Co. *v.* Brown, L. R. 3 Eq. 139 (on demurrer to the bill); L. R. 8 Eq. 381 (on final hearing). We have stated in the text the bald and naked doctrine. The case becomes much stronger against the directors where, as in the case first cited, they make false entries in the books which conceal the real nature of the transaction from the members of the company.

[5] Re Faure Electric Accumulator Co., 40 Ch. Div. 141; *s. c.* 58 L. J. Ch. Div. 48; 37 Week. Rep. 116. Compare *post*, § 4109.

how perfect the good faith with which they made the change.[1] So, a provision in the charter of a bank prohibiting any director or other officer, under a penalty of fine or imprisonment, from *borrowing money* from the *bank*, does not exempt a director from liability to the bank for money thus loaned to him. Such a contract, though illegal, will be enforced, because its enforcement is not against public policy, but in conformity with it.[2]

§ **4020. To What Extent Trustees for the Public.** — The directors of corporations created for the performance of *public duties*, such as *railway companies*, are also, in a qualified sense, trustees of their powers for the general public as well as for their stockholders; and hence a contract by which they are to receive a private gain for the exercise of their powers, in a matter wherein the public have an interest, such as the matter of locating a line of railroad or a railway station, is contrary to public policy as being essentially immoral and corrupt in its tendencies; and consequently no such contract can be enforced in a court of justice.[3]

§ **4021. To What Extent Trustees for Creditors.** — To the extent to which the assets of a corporation are a *trust fund* for its creditors, its directors, being the custodians and managers of that fund, are in a sense trustees for such creditors;[4] and in that character they have been held liable to creditors for breaches of trust, in some cases upon the general principles of equity, real or supposed,[5] but more frequently under the operation of statutes.[6]

[1] Re Orthodox &c. Church, 6 Abb. N. C. (N. Y.) 398, 408. Compare *post*, § 4103.

[2] Lester *v.* Howard Bank, 33 Md. 558; *s. c.* 3 Am. Rep. 211. That there are many such statutes, see *post*, § 4285.

[3] Fuller *v.* Dame, 18 Pick. (Mass.) 472; Bestor *v.* Wathen, 60 Ill. 138; Linder *v.* Carpenter, 62 Ill. 309; St. Louis &c. R. Co. *v.* Mathers, 71 Ill. 592; *s. c.* 22 Am. Rep. 122; Holladay *v.* Patterson, 5 Or. 177; Woodstock Iron Co. *v.* Richmond &c. Co., 129 U. S. 643.

[4] *Ante*, § 2960.

[5] *Post*, § 4132, *et seq.*

[6] *Post*, § 4163, *et seq.*

§ 4022. Not Allowed to Make a Profit out of their Trust. Such being the position of directors, equity will not allow them to make a profit out of their trust; and equity will, at the suit of the corporation or the shareholders, relieve against any arrangement by which they attempt to do so.[1] A contract by which a director uses his official power and influence to his own personal advantage, or to the advantage of third persons, and to the disadvantage of the corporation, is immoral and corrupt in the sense that it will not be judicially enforced,[2] but it will be relieved against, at the suit of the company or its stockholders, under principles hereafter stated;[3] or it will, at the election of the corporation, inure to its benefit.[4] It is therefore said to be either void, or to inure to the benefit of the corporation.[5] It has been observed on this subject that the "directors are the trustees or managing partners, and the stockholders are the *cestuis que trust*, and have a joint interest in all the property and effects of the corporation; and no injury that the stockholders may sustain by a fraudulent

[1] Schetter *v.* Southern Oregon Co., 19 Or. 192; *s. c.* 24 Pac. Rep. 25; Keokuk &c. Packet Co. *v.* Davidson, 95 Mo. 467. The following cases state and illustrate the rule as applicable to trustees generally: Ex parte James, 8 Ves. Jr. 337; Fawcet *v.* Whitehouse, 1 Russ. & M. 132; Hichens *v.* Congreve, 1 Russ. & M. 150, note; Kimber *v.* Barber, L. R. 8 Ch. 56; Bentley *v.* Craven, 18 Beav. 75; Gillett *v.* Peppercorne, 3 Beav. 78; Michoud *v.* Girod, 4 How. (U. S.) 503; Hamilton *v.* Wright, 9 Clark & Fin. 111; Blisset *v.* Daniel, 10 Hare, 493; Tennant *v.* Trenchard, L. R. 4 Ch. 537; Bowes *v.* City, 11 Moore P. C. 463; Tyrrell *v.* Bank, 10 H. L. Cas. 26 (affirming *s. c.* 27 Beav. 273). This rule is applied with full force to directors of corporations. Great Luxembourg R. Co. *v.* Magnay, 25 Beav. 586; Imperial Mercantile Credit Asso. *v.* Coleman, L. R. 6 H. L. Cas. 189 (reversing *s. c.* L. R. 6 Ch. 558); York &c. R. Co. *v.* Hudson, 16 Beav. 485; Parker *v.* McKenna, L. R. 10 Ch. 96; Parker *v.* Nickerson, 112 Mass. 195; European &c. Co. *v.* Poor, 59 Me. 277; Redmond *v.* Dickerson, 9 N. J. Eq. 507, 509; *s. c.* 59 Am. Dec. 418; Pickering's case, L. R. 6 Ch. 525; Madrid Bank *v.* Pelly, L. R. 7 Eq. 442; Ex parte Bennett, 18 Beav. 339; Cumberland Coal Co. *v.* Sherman, 30 Barb. (N. Y.) 553; Butts *v.* Wood, 37 N. Y. 317; Blake *v.* Buffalo Creek R. Co., 56 N. Y. 485; Gaskell *v.* Chambers, 26 Beav. 360; Hodges *v.* New England Screw Co., 1 R. I. 312; *s. c.* 53 Am. Dec. 624.

[2] Attaway *v.* Third Nat. Bank, 93 Mo. 485.

[3] *Post*, § 4479, *et seq.*

[4] Sargent *v.* Kansas &c. R. Co., 48 Kan. 672; *s. c.* 29 Pac. Rep. 1063.

[5] *Ibid.*

breach of trust can, upon the general principles of equity, be suffered to pass without remedy."[1] Another court has said: "When agents, and others acting in a fiduciary capacity, understand that these rules will be rigidly enforced, even without proof of actual fraud, the honest will keep clear of all dealings falling within their prohibition, and those dishonestly inclined will conclude that it is useless to exercise their wits in contrivances to evade it."[2] In giving the opinion of the court in a well-considered case, Mr. Justice Miller said: "That a director of a joint-stock corporation occupies one of those fiduciary relations where his dealings with the subject-matter of his trust or agency, and with the beneficiary or party whose interest is confided to his care, is viewed with jealousy by the courts, and may be set aside on slight grounds, is a doctrine founded on the soundest morality, and which has received the clearest recognition in this court and in others."[3] This is an application of the general principle that an agent cannot speculate out of his agency, and that a trustee cannot speculate out of his trust; and that what he gains by such speculation, in the case of an agent belongs to his principal, and in the case of a trustee to the trust fund.[4] The principle has a twofold operation: If the contract is executed, and the director or other fiduciary has received the benefit, the law appropriates the benefit to the corporation or other *cestui que trust;* but if the agreement remains executory, the law avoids it altogether. "The law avoids contracts and promises made with a view to place one under wrong influences,—those which offer him a temptation to do that which may affect injuriously the rights and interests of third persons."[5] Or as again stated: "It is a sufficient objection to a contract, on the ground of public policy, that it has a direct

[1] Koheler *v.* Black River &c. Co., 2 Black (U. S.), 715, 721, opinion by Davis, J.

[2] Bain *v.* Brown, 56 N. Y. 285, 288.

[3] Twin-Lick Oil Co. *v.* Marbury, 91 U. S. 587, 588; *s. c.* 3 Cent. L. J. 98; 13 Alb. L. J. 112.

[4] Jacobus *v.* Munn, 37 N. J. Eq. 48; Atlee *v.* Fink, 75 Mo. 100; *s. c.* 42 Am. Rep. 385; Bliss *v.* Matteson, 45 N. Y. 22; Tobey *v.* Robinson, 99 Ill. 222.

[5] Fuller *v.* Dame, 18 Pick. (Mass.) 472.

tendency to induce fraud and malpractice upon the rights of others, or the violation or neglect of high public duties."[1]

§ 4023. Personally Liable for Breaches of their Trust. — Directors of corporations are personally liable to surrender profits which have accrued to them, or to make good losses which have been inflicted upon the corporation through breaches of their trust, — to the corporation itself;[2] or where the corporation will not sue, to its stockholders;[3] and in some cases to creditors and strangers.[4]

§ 4024. Must Account to the Company for Secret Profits. — It is familiar doctrine of the courts of equity that a trustee will not be permitted, without the knowledge and consent of his principal, to speculate out of his trust, or to retain any gain which may have accrued to him personally therefrom, but that he must account to his *cestui que trust* for all profits which he may make out of the trust relation.[5] This rule is applied with full force to directors of corporations.[6] If such

[1] Spinks *v.* Davis, 32 Miss. 152, 156.

[2] *Post*, § 4118.

[3] *Post*, § 4479; Perry *v.* Tuscaloosa Cotton-Seed Oil-Mill Co., 93 Ala. 364; *s. c.* 9 South. Rep. 217.

[4] *Post*, § 4138.

[5] Perry on Trust, § 427, *et seq.;* Tennant *v.* Trenchard, L. R. 4 Ch. 537; Blisset *v.* Daniel, 10 Hare, 493; Hamilton *v.* Wright, 9 Clark & Fin. 111; Michoud *v.* Girod, 4 How. (U. S.) 503; Gillett *v.* Peppercorne, 3 Beav. 78; Bentley *v.* Craven, 18 Beav. 75; Kimber *v.* Barber, L. R. 8 Ch. 56; Ex parte James, 8 Ves. 337; Fawcet *v.* Whitehouse, 1 Russ. & M. 132; Hichens *v.* Congreve, 1 Russ. & M. 150, note.

[6] Great Luxembourg R. Co. *v.* Magnay, 25 Beav. 586; Imperial Mercantile Credit Asso. *v.* Coleman, L. R. 6 H. L. Cas. 189; 42 L. J. (Ch.) 644; reversing *s. c.* L. R. 6 Ch. 558; 18 Week. Rep. 570; 22 L. T. (N. S.) 357; York &c. R. Co. *v.* Hudson, 16 Beav. 485; Parker *v.* McKenna, L. R. 10 Ch. 96; Parker *v.* Nickerson, 112 Mass. 195; European &c. R. Co. *v.* Poor, 59 Me. 277; Redmond *v.* Dickerson, 9 N. J. Eq. 507, 509; *s. c.* 59 Am. Dec. 418; Pickering's case, L. R. 6 Ch. 525; Madrid Bank *v.* Pelly, L. R. 7 Eq. 442; Ex parte Bennett, 18 Beav. 339; Cumberland Coal Co. *v.* Sherman, 30 Barb. (N. Y.) 553; Hodges *v.* New England Screw Co., 1 R. I. 312; *s. c.* 53 Am. Dec. 624; 3 R. I. 9; Butts *v.* Wood, 37 N. Y. 317; Blake *v.* Buffalo Creek R. Co., 56 N. Y. 485; Barnes *v.* Brown, 80 N. Y. 527; Keokuk &c. Packet Co. *v.* Davidson, 95 Mo. 467; Ward *v.* Davidson, 89 Mo. 445, 458; Perry *v.* Tuscaloosa Cotton-Seed Oil-Mill Co., 93 Ala. 364; *s. c.* 9 South. Rep. 217; Thomas *v.* Sweet, 37 Kan. 183; *s. c.* 14 Pac. Rep. 545.

a director, acting for himself, proposes to the company a contract, from the execution of which he will derive profit, that profit belongs to the company.[1]

§ 4025. Rule not Applicable to Dealings Open and Acquiesced in. — The rule does not mean that a trustee is absolutely prohibited from making a profit out of his trust relation. It means that he must not make a *secret* profit out of it. His duty is not to avoid, wholly, the doing of any thing for his own benefit; for the class of trustees we are considering, the directors of corporations, are generally interested in the subject-matter of the trust.[2] His obligation, to the beneficiaries in the trust is to make a full, fair, and complete disclosure of all the circumstances attending any transaction which will benefit himself in any manner different from the manner in which all the shareholders will be benefited.[3] If the body of the shareholders are made fully

[1] Imperial Mercantile Credit Asso. *v.* Coleman, L. R. 6 H. L. Cas. 189. Obviously, a director, receiving from his company shares of stock for which he has paid nothing, will be compelled to account to the company for his profits on the sale thereof. York &c. R. Co. *v.* Hudson, 16 Beav. 485; Parker *v.* McKenna, L. R. 10 Ch. 96. Or he will be compelled to pay the value of the shares, if retained by him, as where qualification shares are allotted to a director at the expense of the company. Carling's case, L. R. 20 Eq. 580; Hay's case, L. R. 10 Ch. 593; Mitcalfe's case, 13 Ch. Div. 169. The directors of a company secretly receiving a *bonus* for the performance of their duties will be compelled to yield it up to their company. Gaskell *v.* Chambers, 26 Beav. 360; General Exch. Bank *v.* Horner, L. R. 9 Eq. 480; Madrid Bank *v.* Pelly, L. R. 7 Eq. 442. See also Maxwell *v.* Port Tennant &c. Coal Co., 24 Beav. 495. It has been held that the *solicitor* and *engineer* of a corporation, organized under a special act providing that the expenses of obtaining it shall be paid by the company, who negotiate a contract for the construction of the plant of the company, providing that the expenses of procuring the act shall be paid by the contractors, and subsequently negotiate a contract between themselves and the contractors by which, in consideration of a certain sum, they undertake to relieve the contractors of liability for the expenses of obtaining the act, must account to the company for the balance of such sum, after defraying the expenses sanctioned by the act; since any agreement for the payment of other expenses is illegal and void though adopted by the company. Mann *v.* Edinburgh Northern Tramways Co., (H. L. Sc.) [1893] A. C. 69.

[2] See Hedges *v.* Paquett, 3 Or. 77.

[3] See Cavendish-Bentinck *v.* Fenn, 12 App. Cas. 652, where, though this principle was recognized, the transaction was sustained.

acquainted with the nature of the transaction, and agree to it, and agree that he shall have and retain the special benefit that may accrue from it, then they will not be heard afterwards to claim that this benefit shall be surrendered up to them as a profit which he ought not, in good conscience, to retain. The rule is the same where, *after* the transaction has taken place, they, being put in full knowledge of the nature of the transaction, freely choose to *ratify* it.[1] What acts amount to a ratification under such circumstances would involve a long discussion;[2] but, as in every other case where a principal is put in full knowledge of the facts of an unauthorized act of his agent, he must either ratify or repudiate; he cannot both approbate and reprobate; he cannot ratify in part and reject in part.[3] This is especially true where the transaction results in no possible loss to the corporation. Thus, where a corporation held a leasehold interest in land, with the privilege of purchasing the fee, it was held that an assignment of the privilege to one of the directors, and his purchase of the fee by means of it, would be upheld as against the corporation, where it appeared that the corporation had neither the money nor the credit to make the purchase for itself.[4]

§ 4026. Rule Subject to the Maxim that He Who Seeks Equity must do Equity.—Nor is the class of frauds we are considering of such a nature as to absolve the company from the maxim that "he who seeks equity, must do equity." Because a director of a company may have sold to the company, at an extortionate valuation, property which they supposed he was purchasing for them from another, but which really belonged to himself, it does not follow that the company may confiscate the property altogether, and not pay him any

[1] The same rule has been applied as against shareholders subsequently coming in *without* knowledge, where all the existing members of the company *had knowledge* at the time of the transaction: Re British Seamless Paper Box Co., 17 Ch. Div. 467.

[2] See *post*, § 5314, *et seq.*

[3] Great Luxembourg R. Co. *v.* Magnay, 25 Beav. 586.

[4] Hannerty *v.* Standard Theater Co., 109 Mo. 297; *s. c.* 19 S. W. Rep. 82.

thing for it. He will be entitled to retain what it was really worth, and will be obliged to disgorge the unconscionable profit which he has received. Nor will what he may have given for the property be taken as the conclusive standard of its value. "He may have have acquired it by gift, devise, or by descent; and though he never paid any money for the property, still he is in all these cases equally entitled to the beneficial interest, and to be paid for the property if it be taken away."[1] So, where a contract had been made for the building of a railroad, between the railroad company and a *construction company*, and two of the directors of the railroad company were stockholders in the construction company, and it was a part of the transaction that other parties should assume the subscriptions to the stock of the railroad company (which was worthless) of all the individual directors of that company, and relieve them from liability under it,—it was held that, although the contract was such a one as no court of justice would enforce, yet when the stockholders of the railroad company intervened in a suit to foreclose a mortgage given to secure the bonds which had been issued to the construction company, which bonds had passed into the hands of another railroad company which did not occupy the position of an innocent purchaser,—they subjected themselves to the equitable principle that he who seeks equity must do equity, and that they could get relief against the fraudulent contract only on the principle of paying them for what they had actually received, that is to say, of paying not the contract value, but the *real value* of the work performed by the construction company,—to which extent the bondholders were entitled, if not reimbursed, to a decree of foreclosure.[2] But it is said to be a general rule of equity that *fraud* or any *gross misconduct* on the part of the *salvors* in connection with the property saved, will work *forfeiture of the salvage*. Applying this principle,

[1] Great Luxembourg R. Co. *v.* Magnay, 25 Beav. 586, *per* Sir John Romilly, M. R.

[2] Thomas *v.* Brownville &c. R. Co., 109 U. S. 522; reversing on this point *s. c.* 2 Fed. Rep. 877, and 1 McCrary (U. S.), 392. The same principle was applied in Wardell *v.* Union Pac. R. Co., 4 Dill. (U. S.) 339; and the decree was affirmed in 103 U. S. 651.

where a director advanced money to redeem the bonds of the company from a pledge, and charged the money to the company and received its notes therefor, and then attempted to levy upon and sell the bonds, and himself become the purchaser of them at a nominal sum, thus gaining an unconscionable advantage over the other bondholders,—it was held that no allowance should be made to him for the money thus advanced by him.[1]

§ **4027. Must Account for Bribes Given to Influence their Official Action.** — Gifts, gratuities, or bribes, given to a director to influence his official action, must be accounted for by him and surrendered to the company.[2] If the directors of a corporation receive a sum of money as a *bribe* for the doing of a certain act which may or may not be prejudicial to their company, they are *trustees in equity* of the fund so corruptly received, and the company may also proceed against them for the *damages* it has thereby suffered. Although such an agreement is void,[3] there is no doubt that both remedies are open to it. The corporation may proceed against them *at law* or *in equity* for *damages* for the breach of trust.[4] Thus, the directors of a company, on the transfer of its business to another company, received from the latter a large sum as compensation, the particulars of which they withheld from their members. It was held that they were trustees of this money for the members, and they were ordered, on an interlocutory application, to pay it into court.[5] So, it has been held that, where a director of a corporation accepts a gratuity from a third person, in consideration of voting or acting in a certain way in his character of director, the money thus received by him is, in the eye of equity, deemed to be received for the corporation whose director he is, and is to be held in trust for it; and

[1] Richardson *v.* Green, 133 U. S. 30.

[2] Metropolitan Bank *v.* Heiron, 5 Ex. Div. 319; *s. c.* 31 Moak. Eng. Rep. 717, and other cases below.

[3] Bliss *v.* Matteson, 45 N. Y. 22.

[4] Simons *v.* Vulcan Oil & Mining Co., 61 Pa. St. 202; *s. c.* 100 Am. Dec. 628; Thomp. Off. Corp. 172.

[5] Gaskell *v.* Chambers, 28 Beav. 360. A similar case is Weston's case, 10 Ch. Div. 579.

upon a bill in equity and a disclosure of the fact, he will be compelled to hand over the same to such corporation or its representative.[1] So a *gift* by the *promoter* of a company to a director thereof, made while there are questions open between the company and the promoter, must be accounted for by the director to the company; and the company may claim either the thing given, or its highest value while held by the director.[2] With reference to the effect of the *statute of limitations* upon the right of action of the corporation to recover from its unfaithful director a bribe so taken, it has been held that the statute begins to run from the date of the *discovery of the fraud.*[3]

§ 4028. Not Chargeable with Profits Made by a Third Party out of their Trust Relation. — The rule, however, has been held not to extend so far as to charge a trustee with profits which a *third party* has been able to make out of his trust relation. Thus, where a director in a corporation was also a partner in a firm of real estate brokers, and a gratuity of $15,000 in securities was paid to the partner of such director, in consideration of such director voting and favoring a sale of the assets of the corporation of which he was a director to another corporation, and thereafter such securities were equally divided between himself and his partner, it was held, in a suit in equity by a receiver of the corporation of which he was thus a director, that he must account for the securities actually received by him or for their value, but that he ought not to be compelled to account for those received by his partner in the real estate business.[4] One of the judges doubted, and seemed inclined to hold that he ought to account

[1] Bent *v.* Priest, 10 Mo. App. 543, 557, 558; *s. c.* affirmed, 86 Mo. 475. Compare Bent *v.* Lewis, 15 Mo. App. 40, 578. This latter case was reversed by the supreme court, 88 Mo. 462, but the principles upon which the intermediate appellate court proceeded, and which were announced in Bent *v.* Priest, *supra*, were adhered to.

[2] Eden *v.* Ridsdales Railway Land &c. Co., 23 Q. B. Div. 368.

[3] Metropolitan Bank *v.* Heiron, 5 Ex. Div. 319; *s. c.* 31 Moak. Eng. Rep. 717.

[4] Bent *v.* Priest, 10 Mo. App. 562; *s. c.* affirmed, 86 Mo. 475.

for the whole consideration which was paid for the influence of his vote, not only the share which he received himself, but the share which he turned over to his business partner; and probably this was the correct view.

§ **4029. Illustrations Showing Liability to Account for Secret Profits.** — When, therefore, the director of a bank lent moneys of the bank upon a note drawn in favor of the bank at a stipulated interest, but on a secret agreement with the borrowers that he, the director, should participate in the profits of certain lands which they were to purchase with the moneys, it was held that he was bound to surrender to the bank the profits so acquired.[1] The directors of a life insurance company, on the transfer of its business to another company, received from the latter a large sum for compensation, the particulars of which they withheld from their members. It was held that they were trustees of the money for the members (the profits of the company being divisible among the policy-holders), and they were ordered, on an interlocutory application, to pay it into court.[2] So, a director who, by agreement with his co-directors, sells the bonds of the corporation on his private account, must account, for the *profit* realized, to creditors or stockholders.[3] So, officers and directors who employ the funds of the corporation in projects not authorized by the charter or governing statute, must account for the profits which they thus realize.[4] The principle applies to *promoters*, as already seen.[5] Those who "stock" the property which they themselves own, by getting up companies to purchase it, assume a position of trust and confidence to the coadventurers whom they induce to join in the scheme, and are bound to deal with them openly and to make full and fair disclosures; and they or their associates will be liable to the corporation or to its shareholders, for any secret profit which they may have made in the operation.[6] So, if the president of a corporation

[1] Farmers' &c. Bank *v.* Downey, 53 Cal. 466; *s. c.* 31 Am. Rep. 62.

[2] Gaskell *v.* Chambers, 26 Beav. 360.

[3] Widrig *v.* Newport Street R. Co., 82 Ky. 511. Of course, if he has contracted to take title in his own name and then convey to the corporation, the case stands on a different principle, and he can be compelled in equity to take title and convey: Einsphar *v.* Wagner, 12 Neb. 458.

[4] Ward *v.* Davidson, 89 Mo. 445; *s. c.* 1 S. W. Rep. 846.

[5] *Ante*, § 456, *et seq.*

[6] McElhenny's Appeal, 61 Pa. St. 188; Simons *v.* Vulcan Oil Co., 61 Pa. St. 202; *s. c.* 100 Am. Dec. 628.

takes to himself a deed of *land* in settlement of a debt due from the grantor to the corporation, and improves the land with money of the corporation charging his own account with the debt and the expenditure, he *holds in trust* for the corporation.[1]

§ **4030. Further Illustrations.** — As Mr. Perry has justly said, contracts made between a contractor and the company are not void, but the same rules apply to them as to the cases of other *cestuis que trust;* the burden is upon the trustee to vindicate the transaction from all suspicion.[2] When, therefore, a director of a coal and coke company advanced money, from time to time, under an agreement that he should receive a bonus, or commission of £6 per ton on all produce sold by the company, and the account between him and the company, as entered in the company's books, showed the payment of this commission, the court of chancery refused to allow it, and directed an account to be taken, allowing interest on the advance at the rate of five per cent.[3] . . . . Another case may be aptly cited to show how far this rule is carried. A municipal corporation was authorized by statute to issue its debentures in aid of a railway. The mayor of the corporation was very active in carrying the scheme through. By an agreement between the railway company and its directors, the debentures were issued to the latter, who sold them at a discount of twenty per cent to a partnership firm, of which the mayor of the city was a member, and this firm realized a profit from the transaction. It was held, in a suit in equity by the city against the mayor, that he must account to the city for a moiety of this profit.[4] . . . . The president of a packet company, having endeavored to get certain mail contracts for the company, and having failed, was not forbidden by the principle above stated from making a contract in his own behalf for carrying these mails; but, after having done so, his relation to the packet company required that he should use all the facilities afforded by the company in performing the contract; and, under the principle above announced, it was held that he would not be allowed to make a profit out of such use, but that

[1] Palmetto Lumber Co. *v.* Risley, 25 S. C. 309. See, for a further illustration, Budd *v.* Robinson, 126 N. Y. 113; *s. c.* 22 Am. St. Rep. 816; 7 N. Y. Supp. 535.

[2] Perry on Trusts, 2d ed., § 207; citing St. James's Church *v.* Church of the Redeemer, 45 Barb. (N. Y.) 356; Beeson *v.* Beeson, 9 Pa. St. 279.

[3] Ex parte Hill, 32 L. J. (Ch.) 154.

[4] Bowes *v.* Toronto, 11 Moore P. C. 463.

he must account to the company for all that he had received for the service performed by the company in such use.[1] In other words, if the president of such a company gets a contract for the carrying of the mails and carries the mails by the boats of his company, the profits are not his personally, but are the profits of the company, and a court of equity will compel him to account for them and pay them over to the company.[2]

§ **4031. Illustrations Continued.** — The chairman of a railway company allotted a number of unappropriated shares to his nominees. They were sold at a premium, and the proceeds of the sale were received by him. It was held that he was bound to account to the company as trustee for the profits thus made.[3] . . . . The shareholders of a company, in general meeting, placed 12,050 shares of the capital stock of the company at the disposal of the directors. It was held that this disposal to them was simply as trustees of the company, and not for their own personal benefit. The chairman and managing director of the company, who exercised uncontrolled authority in the concerns of the company, sold a considerable part of these shares at a premium. It was held that he must account to the company for the proceeds of such sales, with interest at five per cent. He could not retain such profits, either as a large land-owner on the line, or as a remuneration for his great services, or on the ground of a presumed acquiescence of the shareholders, to be inferred from a presumed knowledge of the share-book.[4] . . . . The chairman of a railway company appropriated various unallotted shares to the use of various persons whose names he did not mention, in order to secure or reward services the nature of which he declined to state, but which it was insinuated was in the nature of "secret service money." It was held that he must account for the proceeds of these shares. He could not discharge himself by the suggestion of an application of them which would not bear the light.[5] . . . . A banking company is established with a nominal capital of £1,200,000, divided into 60,000 shares. The prospectus states that the first issue of these shares is to be 30,000; that the directors are empowered to commence business as soon as they shall see fit, notwithstanding the

[1] Keokuk &c. Packet Co. *v.* Davidson, 95 Mo. 467, 473; *s. c.* 1 S. W. Rep. 846.

[2] *Ibid.*

[3] York *v.* North Midland R. Co., 16 Beav. 485.

[4] *Ibid.*

[5] *Ibid.*

whole capital may not have been subscribed for, and provides that, upon the first allotment of shares, £10,000 shall be paid to the promoters. When only five thousand shares have been subscribed for, and before the company is in a situation to commence business, the directors allot the shares and pay £5,000 to the promoters, who immediately pay to four of the directors, £500 apiece. The directors must restore to the company, or to its representative in case of insolvency, the moneys which they have thus received, though they are not chargeable with that retained by the promoters. The directors could not take and retain this, even as a gratuity. If it had been in fact so tendered them, their answer should have been: "The mere fact that we are directors, and that you could not have obtained the money but by our order, makes it impossible for us to receive anything."[1]

§ **4032. Continued.** — In a joint-stock association created for the purpose of carrying into effect loans and other financial operations, C. (who carried on business as a stockbroker), was a director. An article of the association required that if a director "contracts with the company, or is concerned in, or participates in the profits of any contract with the company, or participates in the profits of any work done for the company, without declaring his interest at the meeting of directors, at which such contract is determined on, or work ordered," his office of director should be vacated. The article further required that he should not vote on such contract or work. C. had entered into an arrangement with P., to "place" the debentures of a railway company for a commission of five per cent. C., at a meeting of the directors, without mentioning his arrangement with P., but merely declaring that he had an interest in the transaction, proposed to the association that it should undertake to "place" these debentures at a commission of one and one-half per cent. The proposal was adopted, and debentures to a very large amount were "placed" by the association. C. was held liable to account to the association for the difference between the two amounts of commission, so far as concerned the debentures which had been actually placed by the association. The words "declare his interest," were construed to mean that the director must declare the nature of his interest, and not declare simply that he had an inter-

[1] Madrid Bank *v.* Pelly, L. R. 7 Eq. 442. Hunt's case, 37 L. J. (Ch.) 278, was decided the same way on similar facts.

est in the transaction.[1] . . . The directors of a manufacturing company purchased for the company certain machinery, and resold it to the company at an advance of $10,000. Although they were at the time of the sale shareholders in the company, it was held that a court of equity would not lend its aid to give effect to this transaction; because the directors of a company cannot thus retain to themselves a secret profit, and for the further reason that such a transaction has the effect of giving a fictitious value to the capital of the company and operates as a fraud upon the public.[2]

§ 4033. Cannot Buy Shares from the Company and Resell at a Profit. — It is plain law that the same person cannot be both buyer and seller, and it is a familiar doctrine of equity that a trustee cannot purchase at his own sale.[3] Upon these grounds a director will not be permitted, with the consent of the body of the corporation, to *buy in shares* of the company from an allottee of them who is unable to perform his contract of purchase, and then resell them at an advance and retain the profit thus made. When, therefore, it appeared that the directors of a joint-stock company, had, in pursuance of a resolution of the body of shareholders, issued an increase of stock, and had that portion of it which was not taken by shareholders taken by a nominee of their own, who turned over a large quantity of it to such directors, who in turn sold it at a profit, it was held that they must account to the company, in a suit in equity afterwards brought against them by its public officer, for the profits so made. After these shares had been so issued, and a portion of them thus wrongfully appropriated by the directors, a new issue of shares was made, called "bonus shares," which were distributed among the shareholders *pro rata*, and credited with payment of £30 per share. It was also held that the directors must account to the company for what profits they had made from becoming allottees of these bonus shares, in respect of that portion of the previous issue of shares which they had, as already stated, improperly appropriated to themselves.[4]

§ 4034. But may Purchase the Shares of Other Stockholders. — We have already seen that the shareholders, con-

[1] Imperial Mercantile Credit Asso. *v.* Coleman. L. R. 6 H. L. Cas. 189. See also Benson *v.* Heathorn, 1 Younge & C. 326.

[2] Redmond *v.* Dickerson, 9 N. J. Eq. 507; *s. c.* 59 Am. Dec. 418.

[3] *Post*, § 4071.

[4] Parker *v.* McKenna, L. R. 10 Ch. 96.

sidered distributively, are *strangers* to the corporation, in the sense which permits them to make and take contracts with it, and to deal with it at arms length.[1] They hold their respective shares in severalty, and the corporation has no interest in them, and is under no duty in respect of them, except the duty, as *trustee* for the shareholders, to register their transfers, to treat them equally in respect of dividends, and the like.[2] When it is considered that a stockholder may freely contract with the corporation, there is no difficulty in concluding that he can do so with a single director. While the directors, as already stated,[3] are trustees for the shareholders, considered as *an aggregate body*, in respect of the conservation of the corporate property and the management of the corporate business, — yet they do not sustain such a relation to them *severally*, as will prevent them from purchasing from a shareholder his shares, without being subject to the rules governing dealings between a trustee and his *cestui que trust*.[4] It has been held that they have a right to buy up the shares of stockholders at less than the par value, and sell them at a profit to another corporation, which thereby acquires a majority of the stock, and so the control of the enterprise. But one court has gone further, and held that directors of a corporation are not trustees for individual shareholders in a sense which prohibits the directors from purchasing the shares of the shareholders without disclosing to them facts within the peculiar knowledge of the directors, which have come to their knowledge in their official capacities, which facts affect the value of the shares.[5] This holding is believed to be unsound, and the dissenting opinion of Chief Justice Downey is to be preferred. Even where no relation of trust exists, it has been held that the vendor is bound to disclose to the vendee facts affecting the value of the property, of which the vendee

[1] *Ante*, § 1076.

[2] *Ante*, §§ 2140, 2486.

[3] *Ante*, § 4009.

[4] Deadrick *v.* Wilson, 8 Baxter (Tenn.), 108; Stark *v.* Soule, 45 Hun (N. Y.), 588; *s. c.* 9 N. Y. St. Rep. 555; Commissioners *v.* Reynolds, 44 Ind. 509; *s. c.* 15 Am. Rep. 245; Carpenter *v.* Danforth, 52 Barb. (N. Y.) 581.

[5] Commissioners *v.* Reynolds, 44 Ind. 509; *s. c.* 15 Am. Rep. 245.

has not the equal power of acquiring a knowledge.[1] This decision proceeds upon a conception which, if extended, would sanction nearly all the fraud and injustice which the managers of corporations have committed against the stockholders. But it is plain that a contract between the directors and a stockholder of a corporation, regarding the sale of stock, is not voidable by the latter on the ground of the trust relation between the parties, when the stockholder is *also a director* of the corporation, and has general charge of its business; because he has equal means of knowledge in respect of its affairs.[2]

§ **4035. But not with the Funds of the Company.**— But the right to make such purchases by the employment of the funds of the company presents a question depending upon entirely different principles. Unless the constitution of the company, that is to say, its charter, governing statute, articles of association, or deed of settlement, expressly and distinctly authorizes the company to purchase its own shares, such purchases are *ultra vires*.[3] The reason is obvious. Such transactions have the effect of distributing the capital stock of the company to particular members, to the prejudice of the rest. If the directors of the company expend the funds of the company in this way, they are guilty of a breach of trust, and a court of equity will compel them to make good the moneys so expended;[4] and, in the event of the insolvency of the company, they will be so chargeable at the suit of creditors.[5]

§ **4036. Purchasing Property from Themselves for the Company.**—A railway company furnished one of its directors with a large sum of money to enable it to purchase the "concession" of another line. He purchased it, as it turned out, from himself, he being the concealed owner of it. This, it was held, was such a

[1] And as to this the author cites, as more or less in vindication of his position, Walsham *v.* Stainton, 1 De Gex, J. & S. 678.

[2] Perry *v.* Pearson, 135 Ill. 218; *s. c.* 25 N. E. Rep. 636.

[3] *Ante*, § 2054.

[4] Hodgkinson *v.* National &c. Ins. Co., 26 Beav. 473.

[5] Evans *v.* Coventry, 25 L. J. (Ch.) 489; *s. c.* on appeal, 8 De Gex, M. & G. 835.

transaction as a court of equity will not allow to stand, but the company was under an obligation, as in all other cases of this kind, after coming into full possession of the facts of the transaction, to adopt or repudiate it altogether. The fact that, pending a suit impeaching the transaction, the company sold the "concession," precluded them from having any relief in equity, either as to the application of the money or otherwise.[1] . . . . In an action by a company to recover from certain of its directors and executors of other deceased directors, secret profits alleged to have been made by such directors, in respect of a purchase of property, before the formation of the company, with the view of reselling it to the company, the ground relied on was that they stood in a fiduciary position to the company; but the evidence did not prove that when they purchased the property, they were promoters of or otherwise in a fiduciary position toward the company afterward formed. It was held that, even if there was a breach of duty on their part, in not informing the company, after it was formed, that the property was their own, so that the company might have rescinded its contract, yet, as rescission was now impossible, the company could not recover the profits they had made.[2]

§ 4037. Buying Property for Themselves and Reselling to the Corporation at a Profit.—On the same principle, if the directors buy property for themselves and then resell it to the corporation at a profit, they will be held to account to the corporation for that profit. Thus, the directors of a ferry company buy a steamboat for themselves as individuals, and, so owning it, buy it of themselves in their character of directors for the company, at a large advance upon its cost, and at a price greatly in excess of its real value. This transaction was held fraudulent as against the company, and they were held

[1] Great Luxembourg R. Co. *v.* Magnay, 25 Beav. 586.

[2] Ladywell Min. Co. *v.* Brookes, 35 Ch. Div. 400; *s. c.* 56 L. J. (Ch.) 684; 56 L. T. (N. S.) 677; 35 Week. Rep. 785. If the owners of property who organize a corporation to work it and convey it to the corporation, are personally indebted for the purchase of it by means of promissory notes which are not secured by any lien upon the property, and one of the owners afterwards takes up the notes, he cannot make the money so expended a claim against the corporation. Ruby Chief Min. &c. Co. *v.* Gurley, 17 Col. 199; *s. c.* 29 Pac. Rep. 668.

bound to restore to the company the profits so made by them.[1] In another case, the defendant, being a director of a joint-stock company, established for the building, purchasing, hiring, and employment of steam vessels, purchased a vessel for £1,340, and afterwards sold it to the company as from a stranger for £1,500, charging the company with a commission of one per cent, the broker's earnest-money, and the expenses of a bill of sale to himself, there being but one bill of sale. It was held that such a transaction could not stand in equity.[2] For the same reason the treasurer of a corporation who purchases stock of the corporation at a discount cannot be allowed, by selling it to the corporation at par, to make the corporation his debtor, and thus extinguish his liability to it for moneys held in his hands as its treasurer.[3]

§ **4038. Liable for Colluding with Promoters.** — When a corporation is "promoted" for the purpose of purchasing certain existing works, it is necessary — often where shares in the corporation are to be paid for the property — to have a board of directors to act for the corporation before the contract can be consummated. These directors must, of course, be shareholders. Where the scheme is fair and honest, these direct-

[1] Parker *v.* Nickerson, 112 Mass. 195. More in detail, the facts of this nefarious transaction were these: The directors of the East Boston Ferry Company voted that the treasurer be authorized to purchase a certain steamboat "at cost of boat and repairs." This steamboat was the property of the Citizens' Ferry Company, of which company they were also the directors and the only stockholders. As the Citizens' Ferry Company, they sold the boat to the East Boston Ferry Company, at a sum much in excess of the "cost of boat and repairs," and divided the proceeds among themselves. In holding the transaction fraudulent, the court decreed that the profits thus made by the directors inured to the benefit of the East Boston Ferry Company; that that company could recover of them personally all that was received by them above the "cost of boat and repairs"; that money expended by them for professional services and expenses in obtaining the charter of the Citizens' Ferry Company, and paid as salaries to themselves as officers of that company, was not a part of "the cost of boat and repairs," and that they were entitled to charge but six per cent interest in making up the amount of the payments made on account of the boat.

[2] Benson *v.* Heathorn, 1 Younge & C. 326.

[3] East New York &c. R. Co. *v.* Elmore, 53 N. Y. 624.

ors, believing that the promotion of the company is desirable, and that the venture will prove profitable, will not hesitate to purchase and pay for the necessary shares to qualify them to act. But where the scheme is a venture of doubtful profit or involves fraud on the part of the promoters, as where it proposes to sell to the corporation property at a price greatly in excess of its real value, or where the promoters are permitted by the vendor to retain out of the purchase-money a large sum for their compensation, then it is necessary for the promoters to find pliant and superserviceable men, if possible of good financial standing, who, for the prospect of gain, and on the promise of indemnity against loss, are willing so to act, for the purpose of carrying out the scheme. The promoters generally agree to furnish the directors with the necessary number of shares to qualify them so to act. This is done in this way: The company is organized and registered. These creatures of the promoters subscribe for the necessary number of shares to qualify them as directors. They then issue to the promoters certain shares which they are to receive as paid-up shares under the scheme of organization, who, in turn, immediately transfer the necessary number to the directors. They then proceed formally to make the contract of purchase of the property, which, according to the scheme, the company was organized to purchase; the promoters pocket their respective shares of the so-called "promotion money," the bubble bursts, and the innocent shareholders, who have *bona fide* subscribed for shares which are not paid up, are called upon as "contributories" to make up a fund for the payment of the outstanding debts. Now, in these cases, the English courts of equity hold the directors, who have taken part in the conspiracy, to the substance of the liability which they in form hold themselves out as having fulfilled. They oblige them to pay for the number of shares necessary to qualify them to act as directors, precisely as though they had subscribed for them and had not paid for them.[1]

[1] Carling's case, L. R. 20 Eq. 580, is an excellent illustration. See also Eden *v.* Ridsdales Land &c. Co., 23 Or. B. Div. 368. Incorporating a *part-*

§ 4039. The Same Subject Continued. — These views seem to be based upon the idea that such a transaction is against public policy, and for this reason cannot be permitted. A more definite and satisfactory foundation for the principle of these decisions is that such conduct constitutes a breach of trust on the part of directors. And this is the view taken in other cases. Thus, before the formation of a company for the purchase of certain property, the vendors agreed with one Hay that he should become a director, they providing him with the forty shares necessary to qualify him. He, thereupon, signed the memorandum of association for forty shares and became a director. At a meeting of the directors, checks were drawn by them on the bankers of the company and given to the vendors in payment of part of the purchase-money. One of these checks, being for the same amount as that due on Hay's shares, was given by the vendors to this person and was paid by him to his own bankers. He then drew a check on his own bankers, which he gave to the company in payment of the sum due on his shares. Of this transaction Mellish, L. J., said: "Now, is it to be tolerated that an agent or trustee, who is in such a situation, shall make a bargain with the vendor that if a sum of money is paid to the vendor without dispute, he shall make a certain allowance to the agent or trustee? . . . . It is idle to say that if there is a rule in a court of equity that a director is a trustee — that he is an agent, and that he cannot make a profit out of his agency unknown to the company — such a transaction as this should stand."[1] In Re Disderi,[2] a company was formed to purchase and carry on an established business of the promoter. By the articles of association the qualification of the directors was twenty-five shares each. By the same instrument a sum was

nership, and turning over to a director partnership money in payment of a debt to director, when not permitted: Rudd *v.* Robinson, 126 N. Y. 113; *s. c.* 22 Am. St. Rep. 816; 7 N. Y. Supp. 535.

[1] Hay's case, L. R. 10 Ch. 593, 604; *s. c.* 44 L. J. (Ch.) 721; 33 L. T. (N. S.) 406. To the same effect is DeRuvigne's case, 5 Ch. Div. 306, 322; Re Englefield Colliery Co., 8 Ch. Div. 388; Pearson's case, 5 Ch. Div. 336; McKay's case, 2 Ch. Div. 1.

[2] L. R. 11 Eq. 242.

specified as the limit, which the directors were not to exceed, in fixing a price for the purchase. It does not appear that the sum named was an unreasonable price for the business, and the promoter, in order to facilitate the transfer of the business to the company, agreed to pay for the qualification shares of all the directors himself. Nevertheless, the transaction was vehemently condemned on the subsequent winding up of the company. Vice-Chancellor Malins said of these directors: "They were all men in a respectable way of life, but they all declined to incur any risk whatever. They were willing to receive fees and dividends, but under no circumstances were they to embark any capital in the company or to incur any liability. It is said that such a position is one becoming a man of honor and respectability to occupy, but I think it inconsistent with the position of a gentleman. I think that when persons hold themselves out as directors of a company, the public have a right to infer that they have embarked their money in the concern. But if they can make themselves directors without incurring any liability, I think such a state of things would be prejudicial to the true interests of society."[1]

§ **4040. Cannot Buy up Claims against the Company at a Discount and Prove Them for the Full Amount.** — It has been laid down that the officers of a corporation cannot purchase any claim against, or interest in, the company, except in trust for the stockholders, after a resolution has been adopted by themselves, as managers, directing one of their company to purchase for the benefit of the company.[2] Certainly a director or other officer of an *insolvent* corporation cannot buy up its debentures at a discount and prove them against the company as a creditor for the full amount.[3] This is especially so where the debentures were issued in pursuance of a scheme of fraud

[1] Compare Forbes's case, L. R. 8 Ch. 768; Lord Claud Hamilton's case, L. R. 8 Ch. 548; Miller's case, 3 Ch. Div. 661; affirmed in 5 Ch. Div. 70.

[2] Kimmell *v.* Geeting, 2 Grant Cas. (Pa.) 125.

[3] Ex parte Larking, 4 Ch. Div. 566; Bulkley *v.* Whitcomb, 121 N. Y. 107; *s. c.* 24 N. E. Rep. 13.

by which the directors, other than the one in question, had enriched themselves at the expense of the company. The director buying up the securities and seeking to prove them against the company in such a case, is chargeable with knowledge of the circumstances under which they were issued.[1] And he has no claim against the company beyond the amount actually expended by him.[2] He must account in equity to the stockholders for the *profits* which he thus makes out of the stockholders.[3] The rule, of course, has no application in a case where the trust relation of the directors has *wholly terminated*. Thus, it has been held that, after an assignment by a corporation for the *benefit of its creditors*, and the sale of its entire assets, one who was its treasurer and a director may purchase debts owing by the corporation, and, having done so, is entitled to participate in the distribution of the fund.[4] So, where the president of a corporation bought up a small claim against it, and took valuable property of the company in part payment, it was held that he should be enjoined from levying an execution for the balance.[5]

§ 4041. View that they may Recover the Amount Expended in Such Purchases. — The sound view would seem to be that where the directors of an insolvent corporation turn aside from their official duties, and use the knowledge acquired by them in their official relations in an attempt to speculate out of the misfortunes of those beneficially interested in its assets, they cannot have the aid of a court of justice at all in getting back what they have expended, or any part of it. Such speculations are essentially corrupt; for they tend to allow the directors to acquire, from the knowledge derived from their official relations, an advantage over the other beneficiaries in the trust in the distribution of the

[1] Ex parte Larking, *supra*.

[2] Bulkley *v.* Whitcomb, *supra*.

[3] Thomas *v.* Sweet, 37 Kan. 183; *s. c.* 14 Pac. Rep. 545; Chouteau Ins. Co. *v.* Floyd, 74 Mo. 286, 291. See also Lingle *v.* National Ins. Co., 45 Mo. 109.

[4] Appeal of Hammond, 123 Pa. St. 503; *s. c.* 23 Week. Not. Cas. 59; 16 Atl. Rep. 419.

[5] Brewster *v.* Stratman, 4 Mo. App. 41.

assets. Under a well-understood rule of public policy, no court should allow itself to be affirmatively moved to any extent in behalf of such a trustee, even for the purpose of saving him from the loss of what he has actually expended. But however this may be, such arrangements will only be *relieved against* in equity to the extent of *forfeiting the profit.* Thus, it has been held that if the directors of an insolvent company, who are also its creditors in a large amount, join an association formed for the purpose of purchasing a controlling interest in a series of mortgage bonds of the company, and for the further purpose of purchasing at a discount the floating debts of the company, with a view of obtaining judgment thereon, and procuring to be sold for their own benefit, under the deed of mortgage, such portion of the property of the company as is embraced therein, and, under the judgment, the remaining portion, — this arrangement will not be deemed fraudulent *per se*, although the debts were purchased at a discount of twenty-five per cent and the judgment obtained, not by the association, but by individual members of it. It is said that the effect of such a purchase would not be, either in law or morals, to discharge the debt, and absolve the company from its obligation to pay. Its only effect would be to limit the recovery of such adventurers to the amount actually paid for the debts.[1]

[1] Kitchen *v.* St. Louis &c. R. Co., 69 Mo. 224, 271; citing Lingle *v.* National Ins. Co., 45 Mo. 109. In the case mentioned in the text, there were in the association persons representing a majority in value of the money raised by it, who had no connection with the company. The case mentioned in the text proceeds mainly on the ground of an entire absence of actual fraud, and on this ground the court distinguished the cases of Jackson *v.* Ludeling, 21 Wall. (U. S.) 616, and Covington &c. R. Co. *v.* Bowler, 9 Bush (Ky.), 468. It is doubtful whether courts of equity look with as much complacency upon transactions where directors are both buyers and sellers, as the opinion in the case of Kitchen *v.* St. Louis &c. R. Co., *supra*, would indicate. Where such conduct is sanctioned, there is no adequate check upon the frauds of those who have control of corporate organizations. That the particular case, however, was rightly decided is unquestionable, and for the conclusive reason that the plaintiffs, by their misconduct, had forfeited their claim to equitable relief. Compare Buckley *v.* Whitcomb, 121 N. Y. 107; *s. c.* 24 N. E. Rep. 13. In another

§ 4042. Cannot Vote upon Question Affecting his Private Interest. — A director cannot, with propriety, vote in the board of directors upon a matter affecting his own private interest, any more than a judge can sit in his own case; and any resolution passed at a meeting of the directors at which a director having a personal interest in the matter voted, will be voidable at the instance of the corporation or the stockholders, without regard to its fairness, provided the vote of such director was necessary to the result.[1] Thus, as we shall hereafter see,[2] if the directors of a company vote themselves a *salary* or compensation for managing its affairs, they may be compelled to *account* in equity for the money so misappropriated. But it should be kept in mind that this is a rule which generally applies only as between the directors and the corporation or the stockholders, and that as respects *third persons* dealing with the corporation in good faith, such vote would be valid.[3] Moreover, it is to be kept in mind that a resolution so passed is not a mere nullity; for it is good until set aside, just as the decision of a judge who is interested in the controversy would be good until reversed.[4] There is one holding to the effect that it will not be set aside because of that fact alone, no fraud or bad faith being charged.[5] Moreover, directors who are themselves wrong-doers, or the partisans of a wrong-doer, are disqualified from acting as the representatives of the corporation in any litigation for the cor-

case, the president of a corporation purchased a judgment of $4,500, against the corporation, for $675. In a proceeding against him by a *creditor* of the corporation to hold him to an individual responsibility for the debts of the corporation, he claimed the right to set off the whole amount of the judgment as a debt due to him. It was held that on account of his trust relation this could not be allowed, but that he was entitled to a credit for no more than the $675, which he had actually paid. Lingle *v.* National Ins. Co., 45 Mo. 109. See *ante*, §§ 3797, 3798.

[1] Chamberlain *v.* Pacific Wool Growing Co., 54 Cal. 103; Graves *v.* Mono Lake Hydraulic Min. Co., 81 Cal. 303; *s. c.* 22 Pac. Rep. 665; Smith *v.* Los Angeles &c. Asso., 78 Cal. 289; *s. c.* 12 Am. St. Rep. 53; 20 Pac. Rep. 677.

[2] *Post*, §§ 4065, 4683.

[3] Baird *v.* Bank of Washington, 11 Serg. & R. (Pa.) 411.

[4] See *post*, § 4065.

[5] Leavitt *v.* Oxford &c. Silver Min. Co., 3 Utah, 265.

recting of the wrong which they are alleged to have committed or approved.[1]

§ 4043. Cannot Deal for Themselves with the Corporate Property.—Directors cannot deal for themselves with the corporate property or business. A director appointed to examine and ascertain what part of the lands of the corporation can be sold without inconvenience, cannot, after examining the property and recommending a sale, *purchase the property himself* at an unfair valuation, and take a conveyance for his own benefit. As such director is incapacitated to purchase for himself, he is also incapable of acting for another person, in making the purchase.[2] In general, he cannot deal in his own behalf in respect of the corporate property, or in respect of any matters involving the exercise of his duties as director.[3] His duty is to manage the affairs of the corporation and carry out the purpose of its formation. A quorum of directors, therefore, cannot engage in a scheme to sell the entire property of the corporation (except its real estate) and transfer to the purchasers the whole business of the corporation, without and against the consent of the other directors and the stockholders.[4] "Trustees cannot, by their

[1] Knoop *v.* Bohmrich, 49 N. J. Eq. 82; *s. c.* 23 Atl. Rep. 118.

[2] Cumberland Coal &c. Co. *v.* Sherman, 30 Barb. (N. Y.) 553; New York &c. Ins. Co. *v.* National Protection Ins. Co., 20 Barb. (N. Y.) 468; Murray *v.* Vanderbilt, 39 Barb. (N. Y.) 140. Compare Smith *v.* Lansing, 22 N. Y. 520.

[3] Hoyle *v.* Plattsburgh &c. R. Co., 54 N. Y. 314; *s. c.* 13 Am. Rep. 595; Coleman *v.* Second Ave. R. Co., 38 N. Y. 201; *s. c.* 48 Barb. (N. Y.) 371; Risley *v.* Indianapolis &c. R. Co., 1 Hun (N. Y.), 202; Gray *v.* New York &c. Co., 3 Hun (N. Y.), 383; Redmond *v.* Dickerson, 9 N. J. Eq. 507; *s. c.* 59 Am. Dec. 418; Port *v.* Russell, 36 Ind. 60; *s. c.* 10 Am. Rep. 5; Fuller *v.* Dame, 18 Pick. (Mass.) 472; European &c. R. Co. *v.* Poor, 59 Me. 277; Blatchford *v.* Ross, 5 Abb. Pr. (N. S.) (N. Y.) 434; Paine *v.* Lake Erie &c. R. Co., 31 Ind. 283; Barton *v.* Port Jackson &c. R. Co., 17 Barb. (N. Y.) 397; Flint &c. R. Co. *v.* Dewey, 14 Mich. 477; Pickett *v.* School District, 25 Wis. 551; *s. c.* 3 Am. Rep. 105; Alford *v.* Miller, 32 Conn. 543; Kimmell *v.* Geeting, 2 Grant Cas. (Pa.) 125; Western R. Co. *v.* Bayne, 11 Hun (N. Y.), 166. Compare Stark Bank *v.* U. S. Pottery Co., 34 Vt. 144.

[4] Abbot *v.* American Hard Rubber Co., 33 Barb. (N. Y.) 578; *s. c.* 11 Abb. Pr. (N. Y.) 204; 20 How. Pr. (N. Y.) 199; 21 How. Pr. 193. See also Conro *v.* Port Henry Iron Co., 12

vote and their act, change the business of a corporation organized for the making of woolen or cotton goods, into a manufactory of articles entirely different, although the business of the company may be named in the charter in terms sufficiently general to include the substituted business."[1] *A fortiori*, such a sale will not be permitted to stand, when made by the directors in their own interest; as where four of a board of directors made the transfer before noticed, to a firm of individuals, who forthwith transferred the property and rights to a new company, of which three of the directors just named were members of the directory.[2]

§ **4044. Illustrations.** — A corporation resolved to borrow money upon a mortgage to pay its debts. The president of the company had purchased the debts and caused them to be assigned to a partnership of which he was a member. As the president of the corporation, he executed the mortgage to the partnership to secure the debts. It was held in an action to foreclose the mortgage that this transaction was invalid because of the fiduciary relation between the president and the corporation.[3] . . . . For the same reason, a promissory note made by a corporation to its trustees has been held against public policy and void.[4] . . . . A school director obtained a contract for the building of the schoolhouse for the district of which he was director, and took part in the proceedings of the board which let the contract. For the reasons stated in the preceding section, it was held that the contract was void and would not support an action.[5] . . . . Where a board of directors of a mining

Barb. (N. Y.) 27, 64; Ward *v.* Sea, Ins. Co., 7 Paige (N. Y.), 294; Hartford &c. R. Co. *v.* Croswell, 5 Hill (N. Y.), 383; *s. c.* 40 Am. Dec. 354; Rollins *v.* Clay, 33 Me. 132; Kean *v.* Central R. Co., 9 N. J. Eq. 401; Bank Commrs. *v.* Bank of Brest, Harr. Ch. (Mich.) 106.

[1] *Ibid.*, *per* Allen, J. See Attorney-General *v.* Utica Ins. Co., 2 Johns. Ch. (N. Y.) 371, 389.

[2] Abbot *v.* American Hard Rubber Co., 33 Barb. (N. Y.) 578. See also Hoffman Steam Coal Co. *v.* Cumberland Coal &c. Co., 16 Md. 456; *s. c.* 77 Am. Dec. 311; Cook *v.* Berlin Woolen Mill Co., 43 Wis. 433; San Francisco &c. R. Co. *v.* Bee, 48 Cal. 398; San Diego *v.* San Diego &c. R. Co., 44 Cal. 106; St. James's Church *v.* Church of the Redeemer, 45 Barb. (N. Y.) 356.

[3] Davis *v.* Rock Creek &c. Co., 55 Cal. 359; *s. c.* 36 Am. Rep. 40.

[4] Wilbur *v.* Lynde, 49 Cal. 290; *s. c.* 19 Am. Rep. 645.

[5] Pickett *v.* School District, 25 Wis. 551; *s. c.* 3 Am. Rep. 105.

corporation makes a nominal lease of the mine owned by the corporation, to a party really acting in the interests of a minority of the stockholders, not in the ordinary course of the business of the corporation, but for the purpose of withdrawing the mine from the control of a board of directors about to be elected at an approaching meeting of the stockholders, and thereby perpetuating the control of the minority, a court of equity will cancel the lease on a bill filed by the corporation for that purpose.[1] . . . . The directors of a savings and building association, who had borrowed all the money of the association and severally given their notes for the amounts loaned and for a bonus in each case in addition, agreed with M., a stockholder, whose stock they wished to buy in and extinguish, to take one of the notes in exchange for the stock. After the agreement, but before the note was delivered, the directors voted that the amount of the bonus in each case should be canceled and indorsed on the note. No indorsement was however made on the note delivered to M., who conveyed the stock with no knowledge of the arrangement. It was held that the agreement among the directors was a fraud upon the association, and of no effect; and that if it were not so, the director whose note was delivered to M. must be regarded as either waiving his claim to the release of the bonus, or as committing a fraud upon M.; and that in either view he had no equitable claim to a deduction of the amount of the bonus from the note.[2] Certain heirs, owning a large tract of unproductive land, made several agreements in accordance with which the executors sold the land to a company formed for the purpose, one-third of the consideration being cash and used to clear incumbrances on the land, the rest being a mortgage secured by stock in the company of a face value four times as large as the mortgage. By sales of land, one-fourth of the mortgage was paid, and then the managers stopped sales and allowed the interest on the mortgage to go unpaid; the executors sold under the mortgage, and the managers of the company bought through a third person. It was held that the managers sustained such a fiduciary relation to the family that one of the latter was entitled to an injunction restraining the managers from selling or mortgaging, and that a receiver should be appointed to sell under the terms of the original trust.[3]

[1] Mahoney Mining Co. *v.* Bennett, 5 Sawyer (U. S.), 141.

[2] Alford *v.* Miller, 32 Conn. 543.

[3] Raleigh *v.* Fitzpatrick, 43 N. J. Eq. 501; *s. c.* 11 Atl. Rep. 1.

§ 4045. Cannot Conduct their Private Litigation at Corporate Expense.—The directors of a corporation have no right to pay out the money of the corporation as an attorney's fee, for their own defense, against the suit of certain stockholders, which they are apprehensive will be brought to test the validity of their acts.[1] For them to bring actions, nominally for the protection of the corporation, but in reality for the purpose of requiring its officers to settle, out of the corporate property, their individual liabilities, is an abuse of the process of the court, and funds of the corporation paid out by the directors in settlement of such suits may be recovered by it.[2] Where directors thus use the name of the corporation in matters conducted for their private benefit, with knowledge on the part of him with whom they are dealing, it is no defense to an action brought by the corporation for a fraudulent disposition of its property that the corporation is *in pari delicto*, because its name has been used in committing the fraud.[3]

§ 4046. Ratification of Such Contracts by the Shareholders. Transactions of the kind under consideration in this chapter are often said to be *void;* but here, as elsewhere, this word is loosely used in the sense of *voidable.* The true principle is that, unless such a transaction falls within the prohibition of a statute, or of a rule of common law, so that the act done is *malum prohibitum* or against *public policy*, in which case it cannot be ratified,[4]—it is voidable, either at the election of the corporation acting through its directors[5] and officers, or at the election of shareholders, under principles hereafter considered.[6] With this exception, it is capable either

[1] Percy *v.* Millandon, 3 La. 568; *s. c.* 8 Martin (N. S.) (La.), 68.

[2] Erie R. Co. *v.* Vanderbilt, 5 Hun (N. Y.), 123.

[3] *Ibid.*

[4] Barton *v.* Port Jackson &c. R. Co., 17 Barb. (N. Y.) 397; Bartlett *v.* Athenæum Life Soc., 37 Eng. L. & Eq. 187.

[5] Hoyle *v.* Pittsburgh &c. R. Co., 54 N. Y. 314; *s. c.* 13 Am. Rep. 595; Buell *v.* Buckingham, 16 Iowa, 284; *s. c.* 85 Am. Dec. 516; Chouteau *v.* Allen, 70 Mo. 290. But see Wilbur *v.* Lynde, 49 Cal. 290; *s. c.* 19 Am. Rep. 645; San Diego *v.* San Diego &c. R. Co., 44 Cal. 106, 112.

[6] *Post*, § 4479.

of *disaffirmance* or of *ratification.*[1] Subject to exceptions grounded on the doctrine of equitable estoppel and the policy of protecting the rights of innocent third parties,—the general rule may be said to be, that what the corporation cannot do, neither it nor the stockholders can ratify.[2] Thus, as already seen, the better view is that a corporation cannot, with certain exceptions, purchase its own shares. Accordingly it has been held that a sale by the president of a national bank, *to himself and cashier,* of the stock of the bank owned by the bank, may be ratified by the bank or its legal representative; but a sale by himself *to the bank,* of its own stock, where he acts in the double capacity of seller and buyer, cannot be ratified, when the purchase of the stock by the bank is not necessary to prevent loss upon a debt previously contracted.[3]

§ 4047. What will Amount to a Ratification.—If the corporation or the stockholders wish to *disaffirm* the transaction, this must be done *within a reasonable time,* accompanied ordinarily by an offer to put the trustee *in statu quo.*[4] The meaning is that *laches,* that is to say, an *unreasonable delay* after knowledge, especially where new rights have been acquired, will be tantamount to a ratification.[5] Again, an *acceptance* with knowledge, of the *benefits* accruing from the voidable act, will have the same effect. Stockholders who have *assented* to an illegal employment of the funds by receiving their share of the profits arising therefrom, cannot charge the directors personally with a loss resulting from such investment.[6] The principle that an acceptance without *knowledge* of the benefits accruing from a voidable act is not a ratification will often apply, where the question involved is that of

[1] *Post,* § 5314.

[2] *Post,* § 5287.

[3] Bundy *v.* Jackson, 24 Fed. Rep. 628.

[4] Veasey *v.* Graham, 17 Ga. 99; *s. c.* 63 Am. Dec. 228; Ashurst's Appeal, 60 Pa. St. 290; Twin-Lick Oil Co. *v.* Marbury, 91 U. S. 587; United States Rolling Stock Co. *v.* Atlantic &c. R. Co., 34 Ohio St. 450; *s. c.* 32 Am. Rep. 380.

[5] *Post,* § 4085.

[6] Scott *v.* Depeyster, 1 Edw. Ch. (N. Y.) 513. But see Barr *v.* New York &c. R. Co., 52 Hun (N. Y.), 555; *s. c.* 9 N. Y. Supp. 623; Henry *v.* Jackson, 37 Vt. 431; *post,* §§ 5303, 5314.

a *ratification by the shareholders;* but where the question is that of a *ratification by the corporation,* knowledge on its part will frequently be conclusively presumed for the purpose of creating a ratification,—as in the case of the execution by the president of a railway company of a deed, with certain covenants, for the purchase of land for its right of way.[1] Again, where the stockholders have both the knowledge and the power to prevent a proposed voidable arrangement of the directors, and take no action, this may be regarded either as a ratification or a *concurrent consent.* Thus it has been reasoned, that, while an arrangement by which a managing director of a railroad corporation puts forward a third person as a contractor to do work for the corporation, the director designing to secure a special benefit to himself, may be constructively fraudulent, yet where the relation of the director to the contract is not that of an *undisclosed principal,* and the stockholders have knowledge of the facts and power to prevent the consummation of the contract if they choose, actual fraud not existing, *constructive fraud* will not be presumed.[2]

§ 4048. What will not Amount to a Ratification.—It may be stated, as a general proposition, that *if two or more officers of a corporation conspire* to defraud it for their personal gain, their subsequent acts, without more, will not amount to a ratification such as will conclude the corporation or the stockholders. Thus, where a board of directors have conspired to defraud the corporation by a barter of its assets for their private gain, they cannot, by an act by which they assume to accept on behalf of the corporation an equivalent for such assets, conclude the stockholders or their representative from showing that no equivalent was actually received.[3] So, if two officers of a corporation conspire to defraud it for their bene-

[1] Mobile &c. R. Co. *v.* Gilmer, 85 Ala. 422; *s. c.* 5 South. Rep. 138.

[2] Union Pacific R. Co. *v.* Credit Mobilier, 135 Mass. 367. For circumstances which were held to amount to a confirmation or *ratification, by the stockholders* of a corporation, of a sale made by its directors, see Cumberland &c. R. Co. *v.* Sherman, 30 Barb. (N. Y.) 553.

[3] Guild *v.* Parker, 43 N. J. L. 430.

fit, the concurrence of a third officer will not necessarily be a ratification, — as where the president and a director conspire, and the cashier concurs. This may be illustrated by a case where A., who was a director of a bank, owed it a note of one thousand dollars, and held one thousand dollars of its stock. B., the president, under an agreement with A. by which he was to purchase the stock for himself, received it from him, handed it to the cashier, instructing him to hold it in place of A.'s note, and to surrender the note to A., saying that he, B., would pay the amount to the bank. The cashier received the stock, stamped the note paid, and surrendered it to A. It was held that the bank, not having ratified the transaction, was not bound by it, and that A.'s liability on the note was not discharged.[1] But while, as already seen,[2] a director cannot vote in a board meeting upon a proposition in which he is interested in a different way from the stockholders in general, yet, it has been held that if a contract is made with him by the directors, and a *meeting of the stockholders* is called to consider the question of *ratifying* it, he may vote there.[3]

§ 4049. View that Corporation cannot Condone Fraud of Officer except by Unanimous Consent. — Where an action was

[1] Rhodes *v.* Webb, 24 Minn. 292.

[2] *Ante*, § 4042.

[3] North-West Transp. Co. *v.* Beatty, 12 App. Cas. 589, 598; *s. c.* 56 L. J. (P. C.) 102; 57 L. T. (N. S.) 426. In this case a voidable contract had been entered into by directors of a company with one of themselves as sole vendor. The contract was within the powers of the company, and was fair in its terms. It was held that the director who was the vendor might properly vote as a shareholder in a general meeting of the company to ratify such contract; his doing so could not be deemed oppressive by reason of his individually possessing a majority of votes, acquired in a manner authorized by the constitution of the company. But it is perfectly obvious that the doctrine of this case is only a fair-weather doctrine. The principle which prevents a director from voting in the board on the question of a contract with himself is predicated on the idea that the same man cannot properly be on both sides of the same contract, and that a trustee cannot, at the same time, serve two opposing parties. If a stockholder, in a corporation, owes any duty whatever to his coadventurers, such as partners owe to each other, that principle must operate to prevent a majority stockholder from forcing upon his colleagues a contract with himself to which they are opposed, whether a chancellor may deem it fair or unfair.

brought by a stockholder to compel the president of the corporation to account for funds belonging to the company which the president had converted to his own use, and the defendant pleaded a *ratification*, it was said: "To hold that a corporation could gratuitously condone or release such a fraud, by anything short of unanimous consent, would be monstrous; for it would be in effect to hold that a president or director, who can control a majority vote in the corporation, may rob or despoil it with impunity."[1] In like manner, where a stockholder, seeking relief in equity, showed that the directors of a railway company had misapplied and were about to misapply the sum of £100,000, it was said by the vice-chancellor of England: "No majority of the shareholders, however large, could sanction the misapplication of this portion of the capital. A single dissenting voice would frustrate the wishes of the majority. Indeed, in strictness, even unanimity would not make the act lawful."[2]

§ 4050. Rights of Third Persons in Cases of Such Breaches of Trust.—The extent to which third persons dealing with the corporation are bound to take notice of the powers of directors and other officers, is hereafter considered.[3] Where third persons have *actual notice* that a corporate officer is assuming to deal in his own name with the corporate property, they deal with him at their peril.[4]

§ 4051. Measure of Liability for Such Breaches of Trust. In respect of the measure of damages or liability on the part of corporate directors and officers for such breaches of trust as those considered in this chapter, the general rule is that equity aims at *compensation* to those who are beneficially interested in the trust fund,—the corporation, the stockholders, or the creditors; and the court will mould its decree so as to reach

[1] Hazard *v.* Durant, 11 R. I. 195; quoted with approval in First Nat. Bank *v.* Drake, 29 Kan. 311; *s. c.* 44 Am. Rep. 646, 657.

[2] Bagshaw *v.* Eastern &c. R. Co., 7 Hare, 113, 129. See also Kent *v.* Quicksilver Mining Co., 78 N. Y. 159.

[3] *Post*, §§ 5073, 5074.

[4] Davis *v.* Gemmell, 70 Md. 356; *s. c.* 17 Atl. Rep. 259.

this result according to the varying circumstances of each case. It has been held that a director of an insolvent corporation, who purchases its property upon execution sale for less than its value, is chargeable with the property or its value, and with the profits or interest accruing therefrom, as a trust fund for the benefit of the corporation, its creditors and stockholders;[1] that directors of a corporation, who *sell to themselves* its stock at one-third of its par value, are liable to the company and its creditors for full value of the stock.[2] But sometimes a severer rule is applied, in part by way of punishment. Thus, it has been held that where a *cashier* applies the notes of the bank to his own use, he is liable for the *full nominal amount*, and cannot avail himself of their depreciation.[3] Sometimes the fund which has been abstracted will be followed and impounded as a *trust fund;* but not where the fund has lost its identity, or where it has passed into the hands of an innocent purchaser without notice. And it has been held, though not on very clear grounds, that where an officer of a bank fraudulently abstracts the funds, and invests them in his own name, the court cannot declare him a trustee, and indemnify the bank out of the investment.[4] It has also been held that a person who has been employed by a railroad company to buy the stock of a certain person for the purpose of consummating a sale of the corporate property, who buys such stock in his own name, must be regarded as holding it subject to the equitable considerations growing out of an arrangement previously made by his vendor with parties acting in the interest of the corporation, and the most that he can have, after a transfer of the corporate property, is the fair value of the stock at the time of such transfer.[5]

§ 4052. All Directors Liable Who Fraudulently Conspire. If the directors of a corporation conspire together for the

[1] Tobin Canning Co. *v.* Fraser, 81 Tex. 407; *s. c.* 17 S. W. Rep. 25.

[2] Freeman *v.* Stine, 15 Phila. (Pa.) 37.

[3] Pendleton *v.* Bank of Kentucky, 1 T. B. Mon. (Ky.) 171, 177.

[4] Pascoag Bank *v.* Hunt, 3 Edw. Ch. (N. Y.) 583.

[5] Young *v.* Toledo &c. R. Co., 76 Mich. 485; *s. c.* 43 N. W. Rep. 632.

conversion of its assets, each of the conspirators becomes liable, on a well-understood principle, for any act done by any one of them in furtherance of the common design.[1]

§ 4053. Liability of Promoters to Account for Secret Profits. — As already stated,[2] the promoters of a corporation occupy a *fiduciary relation* toward it, which will oblige them to account for any *secret profits* or advantages they may obtain through its organization over those induced to become stockholders in it.[3] They may also, it has been held, be liable in *damages* to those who have been induced to subscribe for shares in the company, and to pay for the same without knowledge of the secret advantage acquired by the promoters; and the action, equally with an action by the corporation to compel them to account for *profits*, proceeds upon the fiduciary relation which the promoters take upon themselves toward those whom they induce to enter into the venture.[4] Nor in such a case will the promoter making the misrepresentations as to the value of the property which he puts in, be exonerated on the ground that it is a representation as to a matter of mere opinion, and not as to a fact, — the representation being as to its actual cost, and false.[5] But it will be observed that the entire English, and some of the American, doctrine would deny the right of action for damages grounded on the mere trust relation, and would sustain it only on the ground of deceit, — a distinction which is not creditable to

[1] Wayen Pike Co. *v.* Hammons, 129 Ind. 368; *s. c.* 10 Rail. & Corp. L. J. 43; 27 N. E. Rep. 487.

[2] *Ante*, § 457, *et seq.*

[3] *Ante*, § 457; Brewster *v.* Hatch, 122 N. Y. 349; *s. c.* 19 Am. St. Rep. 498; 25 N. E. Rep. 505; South Joplin Land Co. *v.* Case, 104 Mo. 572; *s. c.* 16 S. W. Rep. 390; Rice's Appeal, 79 Pa. St. 168; Bosher *v.* Richmond &c. Land Co., 89 Va. 455; *s. c.* 37 Am. St. Rep. 879; 16 S. E. Rep. 360; Teachout *v.* Van Hoesen, 76 Iowa, 113; *s. c.* 14 Am. St. Rep. 206; 40 N. W. Rep. 96; 1 L. R. A. 664.

[4] Brewster *v.* Hatch, 122 N. Y. 349; *s. c.* 19 Am. St. Rep. 498; 25 N. E. Rep. 505. See also Teachout *v.* Van Hoesen, 76 Iowa, 113; *s. c.* 14 Am. St. Rep. 206; 40 N. W. Rep. 96; 1 L. R. A. 664, — where one incorporator recovered damages from another on this ground. Promoters may also be liable in an action *at law* brought by the corporation, for such secret profits. *Ante*, § 466.

[5] Teachout *v.* Van Hoesen, *supra.*

jurisprudence; since where there is a trust relation, there is a duty to disclose, and a failure to disclose is of itself deceit: the rule being that a person may deal at arms-length with the future members of a corporation in selling his property to them only before he assumes the character of promoter.[1] It becomes important in many cases to consider whether this relation had been assumed at the time of the doing of the acts complained of; and upon this question it has been said that "every person, acting by whatever name in the forming and establishing of a company, at any period prior to the company, is considered in law as occupying a fiduciary relation towards the corporation. He is an agent of the corporation, and is subject to the disabilities of such. He is guilty of a breach of trust if he sells property to the corporation, purchased after he began promoting, without informing the company that the property belongs to him; or he may commit a breach of trust by accepting a bonus or commission from a person who sells property to the corporation."[2] According to an official syllabus of a decision by the Supreme Court of Kansas, "to constitute a person a promoter of a railroad corporation, it must affirmatively appear that he was acting for and in behalf of the proposed incorporation, or that he assumed to so act, and that, on the strength of this authority or assumption, the party complaining so dealt with him."[3] And the court held that "the owners of a graded railroad bed can sell the same to a railroad company, whose officers, directors, and stockholders are composed of the owners of the road-bed, and receive in payment therefor shares in the capital stock of the railroad company, at a time when those who sell the road-bed and own and control the railroad company, are the absolute owners of all the stock issued by the railroad

[1] *Ante*, § 457.

[2] Bosher *v.* Richmond &c. Land Co., 89 Va. 455, 460; *s. c.* 16 S. E. Rep. 360, opinion by Lacy, J.

[3] St. Louis &c. R. Co. *v.* Tiernan, 37 Kan. 606, 630; *s. c.* 15 Pac. Rep. 544. In the opinion by Mr. Commissioner Simpson, at pages 630, 631, of the official report, the meaning of the word "promoter," as used in the English case law, is explained at length. As to the meaning of the word "promoter," see *ante*, § 415.

company, and where the terms of sale and the issue of stock are matters of record on the books of the railroad company, and where the transaction occurs months before any other or additional stock is issued by the railroad company."[1]

Article II. Contracts Between the Directors and the Corporation.

Section
4059. Directors may contract with the corporation in good faith.
4060. View that a director cannot contract with the company.
4061. Second view that such contracts are not void, but voidable.
4062. Third view that their validity depends upon their nature and terms.
4063. Such contracts closely scrutinized.
4064. Valid when made with unanimous consent.
4065. Voidable when a majority of the directors constitute the other contracting party.
4066. Director cannot be a secret partner in contracts between the corporation and third persons.
4067. Director may recover at law on a contract with the corporation.
4068. General doctrine that directors may lend to the corporation and take security.
4069. Are entitled to indemnity against *bona fide* expenses and advances.
4070. May purchase from the corporation.
4071. Whether allowed to purchase the corporate property at judicial or other public sale.
4072. Such purchasing director holds as trustee for the company.
4073. Form of relief in such cases.
4074. Circumstances under which such purchases have been upheld.
4075. A mere stockholder may so purchase.

§ 4059. Directors may Contract with the Corporation in Good Faith.—There is no sound principle of law or equity which prohibits one or more of the directors of a corporation from entering into contracts and dealings with the corporation, provided they act in good faith, and provided there be a quorum of other directors on the other side of the contract, so that the vote of the interested director is not necessary to the adoption of the measure; and even in the latter case the contract is *good at law*. In other words, a director is not debarred,

[1] St. Louis &c. R. Co. *v.* Tiernan, 37 Kan. 606, 630; *s. c.* 15 Pac. Rep. 544. Invalidity of agreement by incorporators to give one of them sixty per cent of the present stock for patents not perfected under New Jersey statutes requiring shares to be issued for money or necessary property: Edgerton *v.* Electric &c. Co., 50 N. J. Eq. 354; 24 Atl. Rep. 540.

by reason of his office, from entering into a contract with the corporation, but the contract is subject to the principle that where he appears on both sides of it, it will be closely scrutinized in equity, and set aside unless made in that entire good faith which the law demands of this species of fiduciary.[1] Even where the majority of the stockholders are personally interested in a contract which they have authorized on behalf of the corporation, this does not render the contract void *per se;* it is still good at law, though voidable in equity in case of any fraud or unfairness at the suit of the corporation, or of stockholders suing in its behalf.[2] And so, where a mortgage deed of trust is executed by a corporation, it is not a valid objection to it that it is made to a director in the corporation; since it is made to secure bonds which are purchased by others, and the director is the nominal, and not the beneficiary, grantee. Such a case, it is said, does not fall within the principle sometimes declared that a deed executed by the grantee as agent for the grantor is void as to all the world.[3] There are authorities which go to the length of holding that a contract in which some of the directors are interested on both sides is *void* in such a sense that it will *not be enforced* in a court of justice.[4] But, as we shall hereafter see,[5] the weight

[1] Cases which uphold the principle that directors may contract with the corporation if fairly done, are, Smith *v.* Skeary, 47 Conn. 47; German-American Seminary *v.* Kiefer, 43 Mich. 105; Bassett *v.* Monte Cristo &c. Co., 15 Nev. 293; Barnes *v.* Brown, 80 N. Y. 527; reversing *s. c.* 11 Hun (N. Y.), 315; Jesup *v.* Illinois &c. R. Co., 43 Fed. Rep. 483; Pneumatic Gas Co. *v.* Berry, 113 U. S. 322; Leavenworth *v.* Chicago &c. R. Co., 134 U. S. 688; Barr *v.* Pittsburgh Plate Glass Co., 51 Fed. Rep. 33; Nathan *v.* Whitehill, 67 Hun, 398; *s. c.* 51 N. Y. St. Rep. 457; 22 N. Y. Supp. 63. See also Duncomb *v.* New York &c. R. Co., 22 Hun (N. Y.), 133. Cases asserting the principle that a corporation may contract with its own stockholders: Union &c. Ins. Co. *v.* Frear Stone Man. Co., 97 Ill. 537; *s. c.* 37 Am. Rep. 129; Hennighausen *v.* Tischer, 50 Md. 583.

[2] Bassett *v.* Monte Cristo &c. Co., 15 Nev. 293.

[3] *Ibid.*

[4] See, for instance, Thomas *v.* Brownville &c. R. Co., 2 Fed. Rep. 877; *s. c.* 1 McCrary (U. S.), 392; and note that this decision was affirmed on this point, though reversed in another, in 109 U. S. 522. See also Miner *v.* Belle Isle Ice Co., 93 Mich. 97; *s. c.* 53 N. W. Rep. 218; Jackson *v.* McLean, 36 Fed. Rep. 213.

[5] *Post*, § 4070.

of authority probably is that such contracts are merely *presumptively invalid*, and that the burden of showing that they are entirely fair is upon those claiming under them; and that they will be subjected by courts of equity to the severest scrutiny and set aside unless all appearance of bad faith is removed by the evidence.[1]

§ 4060. View that a Director cannot Contract with the Company. — Some of the courts, however, take the broad and unqualified view that a director cannot be allowed to make and take contracts with a company of which he is a director.[2] The reason is that already stated, that the relation between the director and the corporation is that of trustee and *cestui que trust*,[3] and the law will not allow a trustee for his own private advantage to do that which may place him in a position in which his interest is antagonistic to that of the beneficiaries in the trust.[4] In the leading case on the subject in

[1] Jesup *v.* Illinois &c. R. Co., 43 Fed. Rep. 483; Wardell *v.* Railroad Co., 103 U. S. 651; affirming *s. c.* 4 Dill. (U. S.) 339; Twin-Lick Oil Co. *v.* Marbury, 91 U. S. 587; Gardner *v.* Butler, 30 N. J. Eq. 702; McGourkey *v.* Toledo &c. R. Co., 146 U. S. 536; Welch *v.* Importers' &c. Bank, 122 N. Y. 177; Skinner *v.* Smith, 134 N. Y. 240 (affirming *s. c.* 56 Hun (N. Y.), 437); Risley *v.* Indianapolis &c. R. Co., 62 N. Y. 240 (reversing *s. c.* 1 Hun (N. Y.), 202, and 4 Thomp. & C. (N. Y.) 13); Barnes *v.* Brown, 80 N. Y. 527, 536 (reversing *s. c.* 11 Hun (N. Y.), 315); Munson *v.* Syracuse &c. R. Co., 103 N. Y. 58; Barr *v.* New York &c. R. Co., 125 N. Y. 263. That unfaithful trustees who have appropriated all the profits of the enterprise to themselves will subject the company — it being a mere *trading corporation* — to a *winding up in equity*, see Fougeray *v.* Cord, 50 N. J. Eq. 185; *s. c.* 24 Atl. Rep. 499; and compare *post*, § 4443. That an officer of a corporation cannot, as against its *creditor*, have a remedy on a corrupt contract, see Cole *v.* Millerton Iron Co., 59 Hun (N. Y.), 217; *s. c.* 38 N. Y. St. Rep. 34; 13 N. Y. Supp. 851.

[2] Aberdeen R. Co. *v.* Blaikie, 1 Macq. H. L. (Sc.) 461; *s. c.* 1 Pat. App. (Sc.) 119; Gardner *v.* Ogden, 22 N. Y. 327; *s. c.* 78 Am. Dec. 192; Haywood *v.* Lincoln Lumber Co., 64 Wis. 639; Port *v.* Russell, 36 Ind. 60; *s. c.* 10 Am. Rep. 5; Thomas *v.* Brownsville &c. R. Co., 2 Fed. Rep. 877; *s. c.* 1 McCrary (U. S.), 392, — so holding was *reversed:* 109 U. S. 522; Butts *v.* Wood, 37 N. Y. 317; Coleman *v.* Second Ave. R. Co., 38 N. Y. 201.

[3] Butts *v.* Wood, 37 N. Y. 317.

[4] Aberdeen R. Co. *v.* Blaikie, 1 Macq. H. L. (Sc.) 461, *per* Lord Cranworth; *s. c.* 1 Pat. App. (Sc.) 119; Michoud *v.* Girod, 4 How. (U. S.) 503; Cumberland &c. R. Co. *v.* Sherman, 30 Barb. (N. Y.) 553; Hoffman Steam Coal Co. *v.* Cumberland &c. Co., 16 Md. 456; *s. c.* 77 Am. Dec.

the House of Lords, the rule was thus stated by Lord Cranworth: "A corporate body can only act by agents, and it is, of course, the duty of those agents so to act as best to promote the interests of the corporation whose affairs they are conducting. Such an agent has duties to discharge of a fiduciary character toward his principal; and it is a rule of universal application, that no one having such duties to discharge shall be allowed to enter into engagements in which he has, or can have, any personal interest conflicting, or which possibly may conflict, with the interests of those whom he is bound to protect. So strictly is this principle adhered to, that no question is allowed to be raised as to the fairness or unfairness of a contract so entered into. It obviously is, or may be, impossible to demonstrate how far, in any particular case, the terms of such a contract have been best for the *cestui que trust* which it was possible to obtain. It may sometimes happen that the terms on which a trustee has dealt, or attempted to deal, with the estate or interests of those for whom he is a trustee, have been as good as could have been obtained from any other person; they may even, at the time, have been better. But still, so inflexible is the rule, that no inquiry on that subject is permitted."[1] In conformity with this principle, it has been

311; Andrews *v.* Pratt, 44 Cal. 309; San Diego *v.* San Diego &c. R. Co., 44 Cal. 106; Wilbur *v.* Lynde, 49 Cal. 290; *s. c.* 19 Am. Rep. 645; Pickett *v.* School District, 25 Wis. 551, 552; *s. c.* 3 Am. Rep. 105. The principle may be tersely stated to be that one who undertakes in a given matter to act for another, cannot, in the same matter, act for himself. Dutton *v.* Willner, 52 N. Y. 312, 319; Forbes *v.* Halsey, 26 N. Y. 53, 65. The leading American case on the subject is Gardner *v.* Ogden, 22 N. Y. 327; *s. c.* 78 Am. Dec. 192, — where the subject is discussed with great learning by Davies, J. The rule applies to all persons standing in relations of trust which involve duties inconsistent with such persons dealing with the trust property as their own. Ten Eyck *v.* Craig, 62 N. Y. 406, 420; Wager *v.* Reid, 3 Thomp. & C. (N. Y.) 335. See Rockford &c. R. Co. *v.* Boody, 56 N. Y. 456, 461; Lingke *v.* Wilkinson, 57 N. Y. 445, 455.

[1] Aberdeen &c. R. Co. *v.* Blaikie, 1 Macq. H. L. (Sc.) 461; *s. c.* 1 Pat. App. (Sc.) 119. This decision did not turn upon the construction of any act of Parliament, but was based upon the general principles applied by courts of equity to the relations of trustee and *cestui que trust.* See also Flanagan *v.* Great Western R. Co., L. R. 7 Eq. 116. Similar observations will be found in Cumberland Coal Co. *v.* Sherman, 30 Barb. (N. Y.)

held that a note made by a corporation to its trustees is against public policy and void.[1] Nor can the directors and officers of a corporation make a mortgage to themselves.[2]

§ 4061. Second View, that Such Contracts are not Void, but Voidable. — Another and perhaps a more practicable view, and the one which generally prevails in the American courts, is that a contract between a corporation and its officers is *not void per se*, but is merely voidable at the option of the corporation or its representative, provided the option is exercised within a reasonable time under all the circumstances of the case.[3] But perhaps there is no essential difference between this view and the former; for under this view it is considered that no consideration of its apparent or intrinsic fairness will induce a court, either of law or equity, to enforce it against the resisting *cestui que trust*. Such a contract is, however,

553, opinion by Davies, J.; quoted with approbation in Pickett *v.* School District, 25 Wis. 551; *s. c.* 3 Am. Rep. 105, 109. See also Whichcote *v.* Lawrence, 3 Ves. 740, which was a case of several trustees, where Lord Loughborough said: "There was more opportunity for that species of management which does not betray itself much in the conduct and language of the party, when several trustees are acting together. I am sorry to say there is greater negligence where there is a number of trustees."

[1] Wilbur *v.* Lynde, 49 Cal. 290; *s. c.* 19 Am. Rep. 645. See Daniel Neg. Inst., § 282.

[2] Haywood *v.* Lincoln Lumber Co., 64 Wis. 639. The court cited in support of the general doctrine, Re Taylor Orphan Asylum, 36 Wis. 534, 552; Corbett *v.* Woodward, 5 Sawyer (U. S.), 403; Koehler *v.* Black River Falls Iron Co., 2 Black (U. S.), 715; European &c. R. Co. *v.* Poor, 59 Me. 277; Butts *v.* Wood, 38 Barb. (N. Y.) 188; Scott *v.* Depeyster, 1 Edw. Ch. (N. Y.) 513; Verplanck *v.* Mercantile Ins. Co., 1 Edw. Ch. (N. Y.) 84; Railway Co. *v.* Magnay, 25 Beav. 586; Cook *v.* Berlin &c. Co., 43 Wis. 433; Pickett *v.* School District, 25 Wis. 551; *s. c.* 3 Am. Rep. 105; York &c. R. Co. *v.* Hudson, 19 Eng. L. & Eq. 361, 365.

[3] Thomas *v.* Brownville &c. R. Co., 109 U. S. 522; reversing 2 Fed. Rep. 877; Meeker *v.* Winthrop Iron Co., 17 Fed. Rep. 48; Munson *v.* Syracuse &c. R. Co., 103 N. Y. 58; *s. c.* 8 N. E. Rep. 355; Budd *v.* Walla Walla Printing &c. Co., 2 Wash. 347; Jesup *v.* Illinois &c. R. Co., 43 Fed. Rep. 483; Stewart *v.* Lehigh Valley R. Co., 38 N. J. L. 505; Twin-Lick Oil Co. *v.* Marbury, 91 U. S. 587; Pneumatic Gas Co. *v.* Berry, 113 U. S. 322; Leavenworth County Commrs. *v.* Chicago &c. R. Co., 134 U. S. 688, 704.

valid and enforceable as to others.[1] But it may be repudiated by the company, at the instance of a *stockholder.*[2]

§ 4062. Third View that their Validity Depends upon their Nature and Terms. — A third view is that the validity of such a contract depends very much upon its nature and terms, and the circumstances under which it is made,[3] and that it will be enforced when shown to have been made for the benefit of the corporation, and when it is just, though it will be more closely scrutinized than ordinary contracts.[4]

§ 4063. Such Contracts Closely Scrutinized. — Those courts which concede that a valid contract may be made between a director and his corporation nevertheless unite on the principle, founded on grounds too obvious to require statement, that such contracts will always be regarded with great jealousy and suspicion, and will be subject to the closest scrutiny.[5] Such transactions, it has been said, are viewed with greater odium than a dealing between an ordinary trustee and his beneficiary.[6] In view of this rule, where the directors of a railroad company pledged to each other nearly a million dollars in the bonds of the company, to secure an indebtedness

[1] Stewart *v.* Lehigh Valley R. Co., 38 N. J. L. 505.

[2] Gardner *v.* Butler, 30 N. J. Eq. 702.

[3] Hubbard *v.* New York &c. Investment Co., 14 Fed. Rep. 675; Thomas *v.* Sweet, 37 Kan. 183; *s. c.* 14 Pac. Rep. 545; Appeal of Hammond, 123 Pa. St. 503; *s. c.* 16 Atl. Rep. 419; Central R. &c. Co. *v.* Claghorn, 1 Speer's Eq. (S. C.) 545; Gordon *v.* Preston, 1 Watts (Pa.), 385; *s. c.* 26 Am. Dec. 75; Rogers *v.* Danby Universalist Soc., 19 Vt. 187.

[4] Combination Trust Co. *v.* Weed, 2 Fed. Rep. 24; Hallam *v.* Indianola Hotel Co., 56 Iowa, 178; *s. c.* 9 N. W. Rep. 111. See also Garrett *v.* Burlington Plow Co., 70 Iowa, 697; *s. c.* 59 Am. Rep. 461; 29 N. W. Rep. 395. Under this rule it has been held that a deed by a manufacturing corporation, to secure the individual indebtedness of its president, is *not ultra vires* where the corporation was itself indebted to him in like amount. Bank *v.* Flour Co., 41 Ohio St. 552. Other cases in which such transactions have been upheld: Stewart *v.* St. Louis &c. R. Co., 41 Fed. Rep. 736; Hancock *v.* Holbrook, 40 La. An. 53; *s. c.* 19 Am. & Eng. Corp. Cas. 220; 3 South. Rep. 351.

[5] Conyngham's Appeal, 57 Pa. St. 474; Trust Co. *v.* Weed, 14 Phila. (Pa.) 422.

[6] Chouteau *v.* Allen, 70 Mo. 290, 338, *per* Sherwood, C. J.

of less than four per cent of their nominal value, the court had no difficulty in holding the transaction to be an actual fraud upon the corporation and its stockholders.[1]

§ **4064. Valid when Made with Unanimous Consent.**—On a principle which runs through this whole chapter, such contracts are valid when made by unanimous consent, that is, where all the members of the corporation consent to it;[2] and a subsequent *ratification* will be equivalent to a prior or contemporaneous consent.[3] The doctrine under this head was thus stated by Follett, C. J., in giving the opinion of the Court of Appeals of New York: "It is a general rule that a director, trustee, or an executive officer of a corporation is without power to bind it or its shareholders by a contract authorized by or entered into with himself and for his individual benefit. But if the contract so entered into is in all respects just as between the parties, and all of the shareholders and directors or trustees are competent to assent, and with full knowledge of the terms of the contract, do assent and direct that it be made, it is binding on the corporation, and cannot be avoided by its shareholders or by persons who subsequently become its creditors."[4] It was an obviously correct application of this principle to hold that where there was no deception or fraud practiced, a sale, by a director, of property to a corporation, which is formally approved by the board of directors, and *ratified by all the stockholders*, will not be held invalid because the sale was made for a sum *greatly in excess of the cost* of the property to the director.[5]

[1] Chouteau *v.* Allen, 70 Mo. 290, 338.

[2] Batelle *v.* Northwestern Cement &c. Co., 37 Minn. 89; 33 N. W. Rep. 327. See, for illustration, Welch *v.* Importers' &c. Bank, 122 N. Y. 177.

[3] *Post*, § 5286.

[4] Welch *v.* Importers' &c. Nat. Bank, 122 N. Y. 177, 189; *s. c.* 33 N. Y. St. Rep. 452; 8 Rail. & Corp. L. J. 475; 25 N. E. Rep. 269.

[5] Stewart *v.* St. Louis &c. R. Co., 41 Fed. Rep. 736. Another illustration of the principle, where the property of a failing corporation was sold to some of its trustees, will be found in Skinner *v.* Smith, 134 N. Y. 240; *s. c.* 31 N. E. Rep. 911; affirming *s. c.* 10 N. Y. St. Rep. 81, and 56 Hun (N. Y.), 437.

§ 4065. Voidable when a Majority of the Directors Constitute the Other Contracting Party. — Where the directors who assume to make a contract between the corporation and themselves as individuals, constitute a majority of the board, the contract will not be binding upon the corporation.[1]

§ 4066. Director cannot be a Secret Partner in Contracts between the Corporation and Third Persons. — Moreover, a director cannot make on behalf of the corporation a contract with a third party, and, through a secret understanding between himself and such third party, be a partner in the contract with such third party, or otherwise derive a profit from it. "As the agent to sell cannot purchase what he is to sell, nor the agent to purchase buy of himself, so the agent to contract cannot, as agent, contract with himself as principal. The interests of the parties to a contract, whether of purchase, a sale, or for work or labor, are adverse and inconsistent with each other. It is the duty of the directors of a corporation to act for the best interest of such corporation. If a director be a party to a contract entered into with himself, his duty as an officer is in conflict with his interests as an individual. This is equally so, whether he enters into the contract in its inception, or subsequently acquires an interest in it. If he enters originally into the contract as director, with himself as a party, it is not difficult to perceive who would have an advantage in the bargain. If he subsequently becomes a partner, he places himself in a position in which, when any questions arise as to its performance, his interest as a party to the contract conflicts with his duty as an officer. The general rule is, that directors cannot legitimately acquire an interest adverse to the corporation, and that if they purchase any claim against the company it is in trust for the company."[2] A director can neither

[1] Coleman *v.* Second Ave. R. Co., 38 N. Y. 201.

[2] European &c. R. Co. *v.* Poor, 59 Me. 277, opinion by Appleton, J.; Thomas *v.* Brownsville &c. R. Co., 2 Fed. Rep. 877; *s. c.* 1 McCrary (U. S.), 392; Weston's case, 10 Ch. Div. 579; Wardell *v.* Union Pac. R. Co., 4 Dill. (U. S.) 330.

make a contract on behalf of the company in which he reserves a private interest, nor can he subsequently become interested in its execution with a view to participate in the profits of the contract. Either act will render the contract void, at the election of the *cestui que trust.*[1] Statutes have been enacted in several of the States prohibiting corporate officers from being interested in corporate contracts.[2]

§ **4067. Director may Recover at Law on a Contract with the Corporation.**—A conception which illustrates the incongruity of a system of judicial administration, in which a contract may be either good or bad according to the form of action or kind of remedy, is involved in the proposition that such a contract is *good at law*, the director and the corporation being different persons in theory and fiction of law, and not a partner and his firm. Under this theory, if the director enters into a contract with the corporation, whereby he is to do something for the corporation for a reward, and *executes the contract*, he is entitled to sue the corporation *on the contract* and recover the *agreed price.*[3] But, as fraud is a defense equally in law and in equity, it is supposed that, even here, the company, if the contract is fraudulent, may defend successfully on that ground, at least to the extent of abating the recovery to what is fair. Nor is any reason perceived why a director should not be allowed to recover on an implied *assumpsit* and to

[1] Gilman &c. R. Co. *v.* Kelly, 77 Ill. 426. Other applications of this principle will be found in Great Luxemburg R. Co. *v.* Magnay, 25 Beav. 586; York &c. R. Co. *v.* Hudson, 16 Beav. 199; *s. c.* 19 Eng. L. & Eq. 361; Flint &c. R. Co. *v.* Dewey, 14 Mich. 477; Port *v.* Russell, 36 Ind. 60; *s. c.* 10 Am. Rep. 5.

[2] Bright. Purd. Dig. Pa. 1873, p. 334, § 95; Laws Wyo. 1889, p. 256, § 58; Rev. Stats. N. Y. (Banks & Bros., 6th ed., 1876), vol. II, p. 400, § 9. So in England: 8 & 9 Vict., ch. 16; construed in Paul and Beresford's case, 33 Beav. 204. It has been held that neither the directors nor the stockholders of a corporation can *waive* the provisions of a *statute* forbidding the directors from participating in the benefits of a contract for building a railroad. Barton *v.* Port Jackson &c. R. Co., 17 Barb. (N. Y.) 397. See also Bartlett *v.* Athenæum Life Soc., 37 Eng. L. & Eq. 187. But this is doubtful. Manifestly, they can waive the provisions of any statute intended for their benefit exclusively. See *post*, § 6032.

[3] Ward *v.* Polk, 70 Ind. 309.

the extent of any value which he may fairly have rendered the company outside of his duties as director. Thus, it has been held that where a corporation uses its director's patented invention, he is not precluded from claiming compensation by the fact that he is a director.[1]

§ 4068. General Doctrine that Directors may Lend to the Corporation and Take Security. — The strict rule that directors cannot enter into contracts with the corporation does not seem to be practicable. It would operate to disable those who have already embarked their funds in a corporate enterprise and given to it their personal attention, from assisting it in time of difficulty, except at the risk of doing so without security. A corporation might be in a sorry plight indeed, if one who had already embarked his funds in it, and who, from the fact of his being one of its managers, is best acquainted with its needs and difficulties, should not be able to make a present advance of money to it to help it out of those difficulties. That it is necessary for the law to throw around such transactions the strongest safeguards in order to prevent fraud, need not be argued. Nor should it be forgotten that the right of directors of an *insolvent corporation* to take security for *past advances*, thereby *preferring themselves* over other creditors, stands on quite a different footing.[2] We therefore find the prevailing doctrine to be that the director of a corporation may advance money to it, may become its creditor, may take from it a mortgage or other security, and may enforce the same like any other creditor, — but always subject to severe scrutiny, and under the obligation of acting in the utmost good faith.[3] So,

[1] Deane *v.* Hodge, 35 Minn. 146; *s. c.* 59 Am. Rep. 321.

[2] *Post,* ch. 146.

[3] Hallam *v.* Indianola Hotel Co., 56 Iowa, 178; Beach *v.* Miller, 130 Ill. 162; *s. c.* 17 Am. St. Rep. 291; Mullanphy Savings Bank *v.* Schott, 135 Ill. 655; *s. c.* 25 Am. St. Rep. 401; Gorder *v.* Plattsmouth Canning Co., 36 Neb. 548; *s. c.* 54 N. W. Rep. 830; Johnson *v.* Cottingham Iron &c. Co., 8 Mo. App. 575; Borland *v.* Haven, 37 Fed. Rep. 394; McMurtry *v.* Montgomery Masonic Temple Co., 86 Ky. 206; *s. c.* 5 S. W. Rep. 570; Duncomb *v.* New York &c. R. Co., 88 N. Y. 1; Baker *v.* Harpster, 42 Kan. 511; *s. c.* 22 Pac. Rep. 415;

where advances are made by a director on an agreement that they shall be secured, the other directors may carry out the agreement by causing the proper instrument to be executed;[1] and a court of equity will give effect to such an agreement under proper conditions.[2] So, it has been held that in order to enable a manufacturing corporation to pay its debts, and thus continue its business, its directors may *guarantee* payment of its note made to its own order, and take as security, for their liability, its mortgage of all its property.[3] But in such a case it has been well observed that the obligation of the director, who lends the money and takes the security, to candor and fair dealing, is increased in the precise degree that his representative character has given him power and control, derived from the confidence reposed in him.[4] And all such arrangements are jealously scrutinized in equity and summarily set aside where fraud supervenes.[5] Nor will such an agreement be enforced beyond what is right. As to an excessive interest stipulated for, and as to an amount included therein beyond what was actually parted with, it will not be enforced.[6] And where a director advanced money to redeem bonds of the company from a pledgee, charged the money to the company, received its notes therefor, and then attempted to levy upon and sell the bonds, and himself become the purchaser thereof at a nom-

Stratton *v.* Allen, 16 N. J. Eq. 229; Hayward *v.* Pilgrim Soc., 21 Pick. (Mass.) 270; Geer *v.* School District, 6 Vt. 76; Merrick *v.* Peru Coal Co., 61 Ill. 472; Sawyer *v.* Methodist Episcopal Soc., 18 Vt. 405; Ward *v.* Salem St. R. Co., 108 Mass. 332; Bank Comm'rs *v.* St. Lawrence Bank, 8 Barb. (N. Y.) 436; *s. c.* 7 N. Y. 513; Farmers' &c. Bank *v.* Downey, 53 Cal. 466; *s. c.* 31 Am. Rep. 62; Rider *v.* Union India Rubber Co., 5 Bosw. (N. Y.) 85; Bluck *v.* Mallalue, 27 Beav. 398. There is a valuable note on this subject in 19 Am. & Eng. Corp. Cas. 121; and another in 17 Am. St. Rep. 291.

[1] Baker *v.* Harpster, 42 Kan. 511; 22 Pac. Rep. 415.

[2] Wasatch Mining Co. *v.* Jennings, 5 Utah, 243; *s. c.* 15 Pac. Rep. 65.

[3] Hopson *v.* Ætna Axle & Spring Co., 50 Conn. 597. That directors may become *guarantors* for the corporation, see Taylor County Court *v.* Baltimore &c. R. Co., 35 Fed. Rep. 161.

[4] Addison *v.* Lewis, 75 Va. 701.

[5] Graves *v.* Mono Lake Hydraulic Min. Co., 81 Cal. 303; *s. c.* 22 Pac. Rep. 665; Richardson *v.* Green, 133 U. S. 30; Duncomb *v.* New York &c. R. Co., 22 Hun (N. Y.), 133.

[6] Sutter Street R. Co. *v.* Baum, 66 Cal. 44.

inal sum, and thus gain an unconscionable advantage over other bondholders, no allowance was made to him by way of *equitable salvage*, for the money thus advanced by him.[1] A director, who is a prior mortgagee of a corporation, who votes for the issue of bonds to pay the corporate debts and to secure the same by mortgage on the same property, and who is willing to accept payment of his debt before its maturity, does not thereby waive his priority of lien; nor will the fact that he accepts such bonds to sell, and, failing to negotiate a sale of them, returns them to the corporation, constitute a satisfaction or release of his prior mortgage lien, in the absence of an agreement by him to accept such bonds in payment of his debts.[2]

§ 4069. Are Entitled to Indemnity against Bona Fide Expenses and Advances. — The principle has been declared that, although the directors of a company undoubtedly stand in the position of *agents*, in the sense that they cannot bind their company beyond the limits of their authority, yet they also stand in the position of *trustees*, in the sense which gives them the right to be indemnified against expenses *bona fide* incurred by them in the due execution of their trust. On this principle, directors who had no power to borrow money on behalf of the company were held entitled to be allowed the amounts repaid by them to the company's bankers, for advances made by the latter to prevent the seizure of mines for arrears of wages due laborers.[3] In another case the directors of a railway company, whose borrowing powers had been fully exercised, procured advances from a bank on their own personal security. The moneys so advanced were within the limit of the capital of the company, and were applied in the payment of contractors, or otherwise in completion of the undertaking. The directors subsequently paid off the amount due to the bank. The stockholders, at a general meeting,

[1] Richardson *v.* Green, 133 U. S. 30.

[2] Mullanphy Sav. Bank *v.* Schott, 135 Ill. 655; *s. c.* 25 Am. St. Rep. 401.

[3] Re German Mining Co., 4 De Gex, M. & G. 19; *s. c.* 27 Eng. L. & Eq. 158. Compare Hutchinson *v.* Sidney, 28 Eng. L. & Eq. 472.

sanctioned these proceedings. These directors were held to be entitled to be repaid the amount so paid by them with interest out of the profits of the company, in *priority to dividends* to the holders of *preferred stock*.[1] It is scarcely necessary to add that where the corporation possesses borrowing powers, as American corporations generally do, and in good faith borrows money from its directors, in the ordinary course of its business, to be used in developing its properties, and this money is repaid by the corporation to the directors, — the money so repaid cannot be recovered from the directors by a creditor of the corporation, whose debt was not due and payable at the time;[2] though a repayment to directors of their advances, under such circumstances as to make such repayment a *fraudulent preference*, would stand on a different footing.[3] So, it has been held that the estate of one, who, as president of a bank, has taken the title of land to himself, in trust for the bank, in an attempt to save a debt due to it, and has mortgaged the land for its benefit, is entitled to be protected against a deficiency occurring on the foreclosure of the mortgage, as such acts are within the authority of the president in the fiscal affairs of the bank.[4]

§ **4070. May Purchase from the Corporation.** — The principle which upholds contracts, when fairly made, between a corporation and its directors or officers, allows them, under like conditions, to purchase property from the corporation.[5] Such purchases are not void at law, but are only voidable in equity;[6] and when the purchasing director is guilty of no fraud or concealment, and pays the value of the property, and it is the intention of the directors to sell to him, equity will uphold the sale.[7] Judicial theories seem to shift a little as to

[1] Ulster R. Co. *v.* Banbridge R. Co., Ir. Rep. 2 Eq. 190.

[2] Holt *v.* Bennett, 146 Mass. 437.

[3] *Post*, ch. 147.

[4] Brown *v.* Mechanics' & T. Nat. Bank, 58 Hun (N. Y.), 610 mem.; *s. c.* 35 N. Y. St. Rep. 665; 12 N. Y. Supp. 861.

[5] Beach *v.* Miller, 23 Ill. App. 151; Hartridge *v.* Rockwell, R. M. Charlt. (Ga.) 260.

[6] Little Rock &c. R. Co. *v.* Page, 35 Ark. 304.

[7] Buell *v.* Buckingham, 16 Iowa, 284; *s. c.* 85 Am. Dec. 516.

the conditions under which the corporation or the shareholders are entitled to avoid such a purchase. According to one view it is voidable by the *cestui que trust* at its *mere option*, at least in the case of a purchase by directors.[1] Clearly it is a sound view that whenever the validity of such a transaction is drawn in question in a court of equity, in a direct proceeding, the *presumption* of law is against it; and the burden is upon the purchasing directors to *defend it*, and they must show its fairness *affirmatively*.[2] And, while it has been reasoned that, as to *agents* who are *not directors*, the rule is not always so strictly applied as to make a purchase voidable at the mere instance of the company, yet whenever the nature of the agency is such as to give the agent any advantage in buying the property, — as, for instance, the *superintendent* of a manufacturing company, — any one relying on the agent's purchase must make *affirmative proof* that the agent acted with the most perfect good faith.[3] But where the company issues debentures and puts them on the market and sells them at a discount because they will not bring par, it has been held that a director commits no violation of duty by purchasing some of them at *market rates*. A director commits no misfeasance or breach of trust by advancing money to the company, on the best terms that the company can get from other people.[4] Where a railroad company had contracted for the purchase of certain ties, and they were deposited at the place agreed upon and an installment paid thereon, but under such circumstances that the title did not pass to the company, and, the company becoming insolvent, one of the directors purchased them of the contractor, — it was held that they could not be taken in execution against the company; since, although the director may have been accountable in equity to the

[1] Cook *v.* Berlin Woolen Mill Co., 43 Wis. 433.

[2] Ashurst's Appeal, 60 Pa. St. 290. A sale *to a stockholder* of the corporate property, ordered sold at a general meeting of the stockholders, not all the stockholders being present, there being no board of directors, — has been held *voidable*, though the purchaser paid a *fair price:* Reilly *v.* Oglebay, 25 W. Va. 36.

[3] Cook *v.* Berlin Woolen Mill Co., 43 Wis. 433.

[4] Campbell's case, 4 Ch. Div. 470.

company for the ties by reason of his fiduciary relation to it, yet the *legal title* was in him, and not in the company.[1] Another court has reasoned that in order to vindicate a sale of corporate property to pay corporate debts, made by the board of directors to one of the members of the board, it must be shown that the sale was necessary, that the property was bought in open market at a fair price, in good faith, and without any undue advantage over the corporation.[2] So, it has been held that an assignment to a director of a corporation of an option held by it for the purchase of property of which it has a lease, and his purchase, by means of it, of the fee, are valid as against the corporation; the transfer being made but a few days before the expiration of the option, and the corporation having neither the money nor the credit necessary for making the purchase.[3]

§ 4071. Whether Allowed to Purchase the Corporate Property at Judicial or Other Public Sale. — The principle which allows directors to deal with their corporation and which makes contracts between them and it good in law, though subject to be avoided in equity upon any appearance of unfairness,[4] has an analogy in the principle that directors are not disabled, by the fiduciary relation which they occupy toward the company, from purchasing its property at judicial or other public sales. Such purchases are not wholly void, but they operate to pass the *legal title* to the purchasing director, so that he will hold it as against a purchaser at execution sale under a subsequent judgment against the corporation, in a proceeding at law, such as a writ of entry to obtain possession.[5] But, except where he is himself rightfully its creditor, a director is so far agent or trustee of his corporation as to be within the operation of the rules of law which

[1] Cornell *v.* Clark, 104 N. Y. 451; *s. c.* 10 N. E. Rep. 888.

[2] Crescent City Brew. Co. *v.* Flanner, 44 La. An. 22; *s. c.* 10 South. Rep. 384.

[3] Hannerty *v.* Standard Theater Co., 109 Mo. 297; *s. c.* 19 S.W. Rep. 82.

[4] *Ante*, § 4063.

[5] Saltmarsh *v.* Spaulding, 147 Mass. 224; *s. c.* 17 N. E. Rep. 316.

prevent an agent from purchasing *at his own sale.*[1] The extent of the rule is, that a director purchases subject to the right of the corporation to disaffirm and demand a resale, and that, in order to have the sale disaffirmed, the corporation need not show actual fraud or prejudice.[2] On the one hand, such a transaction is presumptively not *bona fide;* on the other, it is voidable only at the election and instance of a party in interest.[3] Whenever such a purchase is drawn in question in a direct proceeding in equity, the presumption of law is against its validity, and it devolves upon the purchasing director to establish its good faith and show that the sale produced the full value of the property.[4] One reason assigned for the rule is, that for a director to appear as a bidder at a judicial sale of the property of the company would naturally have the effect to prevent bidding.[5]

§ 4072. Such Purchasing Director Holds as Trustee for the Company. — The directors or other officers of a corporation, who thus become the purchasers of its property, hold it as trustees for the corporation.[6] Thus, in an action of

[1] Cumberland &c. R. Co. *v.* Sherman, 30 Barb. (N. Y.) 553; Williams *v.* McKay, 46 N. J. Eq. 25; *s. c.* 18 Atl. Rep. 824; Re Iron Clay Brick Man. Co., 33 Am. & Eng. Corp. Cas. 277; *s. c.* 19 Ont. Rep. 113; Covington &c. R. Co. *v.* Bowler, 9 Bush (Ky.), 468. Under Civil Code, Cal., § 2228, which requires the highest good faith from a trustee towards his beneficiary, and under § 2230, which prohibits the trustee from taking part in any transaction adverse to the beneficiary, the secretary of a corporation, who is also its general manager, and to whom all its affairs are committed, is guilty of a fraud against the corporation in secretly purchasing its property in his own name at execution and tax sales. San Francisco Water Co. *v.* Pattee, 86 Cal. 623; *s. c.* 25 Pac. Rep. 135.

[2] Hoyle *v.* Plattsburgh &c. R. Co., 54 N. Y. 314; *s. c.* 13 Am. Rep. 595. See European &c. R. Co. *v.* Poor, 59 Me. 277, where the rule and the reasons for it are stated at length by Appleton, C. J.

[3] Jones *v.* Arkansas Agricultural &c. Co., 38 Ark. 17. Under the facts of this case, a *creditor* successfully challenged it.

[4] Wilkinson *v.* Bauerle, 41 N. J. Eq. 635; *s. c.* 7 Atl. Rep. 514.

[5] Re Iron Clay Brick Man. Co., 33 Am. & Eng. Corp. Cas. 277; *s. c.* 19 Ont. Rep. 113.

[6] Raleigh *v.* Fitzpatrick, 43 N. J. Eq. 501. It has been held that a director of a corporation who purchases at an execution sale property of the corporation and takes possession of the same, unless he gives notice to the corporation that he claims

ejectment it appeared that, under an execution against a corporation, land held by its trustees was purchased by one who, at the time, was a stockholder in and the treasurer of the company. It was held that the purchase must be regarded as having been made for the benefit of the corporation, and that the title which the purchaser thus acquired could not be considered as hostile to the company.[1] In like manner, where the president of a corporation purchased a note of the company, giving his own note at six months in payment therefor, and then caused suit to be brought against the company on the note, in the name of a third person to whom it had been assigned for that purpose, and the company suffered a judgment by default, and under the judgment an execution was levied upon its property, at the sale under which the president became the purchaser of the property at a nominal sum, — it was held that his *status* was that of a trustee of the corporation in respect of the title to the property; that an *account* ought to be taken between him and the corporation for the purpose of ascertaining what amount, if any, was due to him as holder of the judgment; that the title ought to be revested in the corporation upon its paying to him the sum thus found to be due; and that, in the mean time, there should be an *injunction* against further proceedings under the execution.[2] It is needless to add that if a director takes title in his own name, to property which has been purchased for the corporation *with its money*, a *trust* instantly *results* in favor of the corporation which its alienees can enforce in equity.[3] Thus, the president of a lumber company took a deed of land in his own name in settlement of a debt due to the company (not recording the deed), and erected houses thereon at the expense of the company; but on the suspension of the company, the president charged the debt and expenses to his own account and recorded the deed as to himself. It was held

it in his individual capacity, holds it as an equitable trustee for the corporation, but he can recover what he has individually expended upon it. Hoffman *v.* Reichert, 31 Ill. App. 558.

[1] McAllen *v.* Woodcock, 60 Mo. 174.

[2] Brewster *v.* Stratman, 4 Mo. App. 41.

[3] Buffalo &c. R. Co. *v.* Lampson, 47 Barb. (N. Y.) 533.

that the property was held in trust for the company.[1] And so, where a director purchases for himself property not belonging to the company, but which it is his *duty to acquire for the company*, a trust in it will be declared in favor of the company. Thus, a director who takes a *renewal lease* of a real estate for the benefit of the corporation, in his own name, without the corporation's consent, cannot hold it for his own benefit, or deal with it as his own property; but such renewal inures to the benefit of the corporation, and he is bound to transfer the lease on demand.[2]

§ **4073. Form of Relief in Such Cases.**—In such cases equity will vary its relief to suit the particular exigencies,—preserving the principle that the corporation has a right to a rescission, and that the purchasing director, unless he has been guilty of such bad faith as to put him in the category of a trustee *ex maleficio*, will be allowed to keep, or will have restored to him, what he has actually expended.[3] Thus, where at a judicial sale of a railroad, one of the directors, through another person, became the purchaser without the consent of the corporation or permission of the chancellor who decreed the sale,—it was held that the corporation was entitled to a surrender of the road on placing the purchaser *in statu quo*.[4] In another case a director of a joint-stock company, who at a judicial sale purchased property belonging to it, to satisfy his

[1] Palmetto Lumber Co. *v.* Risley, 25 S. C. 309.

[2] Robinson *v.* Jewett, 116 N. Y. 40; *s. c.* 26 N. Y. St. Rep. 387; 22 N. E. Rep. 224. For further illustration, see a case where certain directors acquired for themselves certain patent rights, which they ought to have acquired for the company. Averill *v.* Barber, 25 N. Y. St. Rep. 194; *s. c.* 6 N. Y. Supp. 255. For other circumstances under which such purchases have been held voidable, see Green *v.* Hugo, 81 Tex. 452; *s. c.* 17 S. W. Rep. 79; *s. c.* 26 Am. St. Rep. 824; Williams *v.* McKay, 46 N. J. Eq. 25; *s. c.* 18 Atl. Rep. 824; Covington &c. R. Co. *v.* Bowler, 9 Bush (Ky.), 468; Welch *v.* Woodruff, 20 N. Y. St. Rep. 840; *s. c.* 3 N. Y. Supp. 622; San Francisco Water Co. *v.* Pattee, 86 Cal. 623; *s. c.* 25 Pac. Rep. 135; Crescent City Brew. Co. *v.* Flanner, 44 La. An. 22; *s. c.* 10 South. Rep. 384.

[3] See, for instance, San Francisco Water Co. *v.* Pattee, 86 Cal. 623; *s. c.* 25 Pac. Rep. 135.

[4] Covington &c. R. Co. *v.* Bowler, 9 Bush (Ky.), 468.

liens against it, was required to account for the *profits* realized by him *on a subsequent sale,* although he paid its full value at the time of its purchase.[1] In another case it was held that property of a corporation purchased by a director at an execution sale for less than its value would be applied at its true value to the discharge of a claim held by him against the corporation, and he would be accountable for the balance.[2] Where the *secretary* of a corporation, who was also its *general manager,* had secretly procured an adverse title to the company's property, by purchasing it in his own name at a judicial sale, he was decreed to make restitution on payment of his expenditures being made to him, and it was held that he was not entitled to have his unpaid *salary* paid to him prior to such restitution, but that in respect of that he stood on a common level with other creditors.[3] Contrary to the general rule that *equity* has no jurisdiction to *dissolve* and *wind up* a corporation,[4] exceptional decisions are noted in the case of *manufacturing* and *trading companies* where, on account of the company falling irretrievably under the control of directors bent on swindling their coadventurers, courts of equity have laid the ax at the root of the tree and granted relief to the minority stockholders in the form of winding up the company, stating an account against the unfaithful directors or managers, paying its debts, and distributing its assets.[5]

§ 4074. Circumstances under Which Such Purchases have been Upheld.—If the right is conceded to a director, under views already stated,[6] of becoming a creditor of the corporation, and of taking security for his debt, then it must be conceded, on parallel grounds, that he has the same right to protect his interests, by buying at a judicial sale or other-

[1] Re Iron Clay Brick Man. Co., 33 Am. & Eng. Corp. Cas. 277; *s. c.* 19 Ont. Rep. 113.

[2] Tobin Canning Co. *v.* Fraser, 81 Tex. 407; *s. c.* 17 S. W. Rep. 25. See also Averill *v.* Barber, 25 N. Y. St. Rep. 194; *s. c.* 6 N. Y. Supp. 255.

[3] San Francisco Water Co. *v.* Pattee, 86 Cal. 623; *s. c.* 25 Pac. Rep. 135.

[4] *Post,* ch. 155.

[5] Fougeray *v.* Cord, 50 N. J. Eq. 185; Miner *v.* Belle Isle Ice Co., 93 Mich. 97; *s. c.* 53 N. W. Rep. 218.

[6] *Ante,* § 4068.

wise, which any other creditor has.[1] As an execution creditor, he has the right, of course, to sell under his execution.[2] Under other circumstances, in a few cases, such sales have been upheld. Thus, where directors of a *land company* bought lands at the sales at fair prices, and the sales were conducted openly and fairly, it was held that the sales to them were valid.[3] Thus, a sale, by several directors of a railroad corporation, of its property, to one who has been a director, but *resigns* in order to make the purchase, has been held *voidable* only, and *not void per se.*[4] Where a corporation is insolvent, and without means to discharge the indebtedness or redeem property sold under a judicial sale, and the directors give all the stockholders an opportunity of making advances to relieve the company from embarrassment, which they refuse to embrace, the directors have the right to purchase such indebtedness, and acquire title to the corporate property, by enforcing a sale under a deed of trust given to secure such indebtedness, and the other stockholders have no right to complain.[5] And where certain of the directors advance money, and rescue the corporation under such circumstances, and buy it in under a sale foreclosing their mortgage, and succeed in reorganizing it, and putting it on its feet, — the other stockholders, who have stood by and refused to come to its rescue when it was in peril, cannot, after it has become prosperous, maintain a bill to *redeem* or to be admitted to a share in the new company.[6]

§ 4075. A Mere Stockholder may so Purchase. — As elsewhere seen,[7] the stockholders of a corporation are distinct

[1] Twin-Lick Oil Co. *v.* Marbury, 91 U. S. 587; *s. c.* 3 Cent. L. J. 98; 13 Alb. L. J. 112. Compare Weir *v.* Barnett, 2 Ex. Div. 32; *s. c.* 26 Week. Rep. 147; Hoyle *v.* Plattsburgh &c. R. Co., 54 N. Y. 314; *s. c.* 13 Am. Rep. 595; Preston *v.* Loughran, 34 N. Y. St. Rep. 391; *s. c.* 12 N. Y. Supp. 313.

[2] Hoyle *v.* Plattsburgh &c. R. Co., 54 N. Y. 314; *s. c.* 13 Am. Rep. 595.

[3] Watt's Appeal, 78 Pa. St. 370. A *payment* in the bonds of the company was held equivalent to payment in cash. *Ibid.*

[4] Searcy *v.* Yarnell, 47 Ark. 269; *s. c.* 1 S. W. Rep. 319.

[5] Harts *v.* Brown, 77 Ill. 226.

[6] Twin-Lick Oil Co. *v.* Marbury, 91 U. S. 587.

[7] *Ante,* § 1071, *et seq.; post,* § 4460.

persons in law from the artificial body, the corporation itself. They may, therefore, deal with the corporation at arms-length, just as any other person may. A stockholder, upon a sale of the corporate property by the sheriff upon execution, may become the purchaser thereof for his own benefit; and if there is no fraud in the sale, he is not accountable to any of the other stockholders although the property is bid in by him at much below its value.[1] "His interest in the company extends to the stock he has subscribed and the consequent rights of one of the corporators; but he is individualized in the contract, and whilst he would be held under it individually responsible, he must have a remedy against the corporation for any failure on its part."[2]

Article III. Contracts Between Two Corporations Having the Same Directors.

Section
4079. Contracts between two corporations not void, although some of the officers in one are officers in the other.
4080. Contract not voidable if there be a quorum of directors not directors in both corporations.
4081. Opposing view that such contracts are voidable.
4082. Voidable where the same persons are directors in both corporations.
Section
4083. Voidable where the sole contracting agent is an officer in both corporations.
4084. Corporate agent employed by the other contracting party.
4085. Such contracts validated by acquiescence and ratification.
4086. Director or officer may be trustee in corporate mortgage.
4087. Contract with stockholder not changeable by corporation without his consent.

§ 4079. Contracts between Two Corporations not Void although Some of the Officers in One are Officers in the Other. — A contract between two corporations, where the same persons are directors and officers in both, is probably not bad *in law;* since, by a fiction of the law, the corporation

[1] Mickles *v.* Rochester City Bank, 11 Paige (N. Y.), 118; *s. c.* 42 Am. Dec. 103.

[2] *Per* Mr. Justice McLean, in Culbertson *v.* Wabash Nav. Co., 4 McLean (U. S.), 544, 547. See also, Gilmore *v.* Pope, 5 Mass. 491; Berks &c. Turnp. Co. *v.* Myers, 6 Serg. & R. (Pa.) 12; *s. c.* 9 Am. Dec. 402; Ely *v.* Sprague, 1 Clarke Ch. (N. Y.) 351; Willoughby *v.* Comstock, 3 Hill (N. Y.), 389.

is a person distinct from the individuals who compose it.[1] But here, as in most other matters in respect of corporations, the weakness of what is called *law* in clinging to fictions, is supplied by the strength of that part of the law which is called *equity*, in cutting through forms and getting at the substance of things. We may then start out with the proposition that the same person may fill the office of *president* of two distinct corporations, and that such identity does not, of itself, invalidate dealings between the two corporations.[2] We may enlarge the proposition by stating that a contract between two corporations is not rendered void by the mere fact that *some* of the persons assisting to make the contract, and taking part in the performance of conditions and in the acceptance of performance, were officers in both corporations, and represented both to the extent of their respective powers.[3] We may state the proposition in another way, by saying that there is no legal presumption of illegality or unfairness, in transactions between two corporations, from the mere fact that *a portion*, less than a quorum, of the board of directors in the one constituted a part of that in the other at the same time, and participated in the dealings between the two; but that is only when their dealings are shown to be prejudicial to one of the corporations represented by them, that they will be set aside by the courts.[4] Although transactions of this kind have been the source of the grossest frauds upon the minority of the stockholders, and incidently upon the public, yet it is plain that a rule of law that would make such contracts absolutely and wholly void, by reason of the directories of the two corporations being composed, in whole or in part, of the same individuals, would produce more evils than those which it seeks to remedy. Take the simple case where the unincorporated owners of certain property desire to form a corpora-

[1] *Ante*, § 1071, *et seq.; post*, § 4460.

[2] Leathers *v.* Janney, 41 La. An. 1120; *s. c.* 6 South. Rep. 884.

[3] Griffin *v.* Inman, 57 Ga. 370.

[4] Booth *v.* Robinson, 55 Md. 419. See also Butts *v.* Wood, 37 N. Y. 317; Coleman *v.* Second Ave. R. Co., 38 N. Y. 201; United States Rolling Stock Co. *v.* Atlantic &c. R. Co., 34 Ohio St. 450; *s. c.* 32 Am. Rep. 380; Flagg *v.* Manhattan R. Co., 10 Fed. Rep. 413.

tion on the basis of that property. They organize a corporation composed of themselves alone. They then, by their joint deed, convey the property to the corporation, that is to say, to themselves in their new corporate character. They pay the purchase price to themselves, issuing in their corporate character their shares to themselves as individuals. Such arrangements are made every day, and are universally held valid where the property is turned into the corporation at a fair price, so that it does not acquire a fictitious capitalization, and thereby defraud future creditors, and where the promoters thus incorporating their property, so to speak, do not defraud shareholders subsequently induced to join.[1] We may therefore conclude that the fact that a part or all of the directors of one contracting corporation are directors of the other contracting corporation, does not destroy the separate identity of the two contracting parties *as matter of law*, nor make the contract into which they enter void *per se*, but that it merely affords a ground for subjecting it to strict scrutiny by a court of equity when challenged by a party entitled to challenge it.[2] For stronger reasons, if there are more than *two* parties to a contract, and two of the parties consist of corporations, and *the same person is president of each*, this circumstance will not prevent the contract from being valid and binding as to a *third party* to the contract;[3] though it may be assumed that if

[1] Saint Louis &c. R. Co. *v.* Tiernan, 37 Kan. 606, 633; *s. c.* 15 Pac. Rep. 544. That individual obligations of purchasers of the property and franchises of a railroad company, given to secure deferred payments of the purchase-money, are supported by a sufficient *consideration* where a deed of the property is made to a new corporation into which they subsequently become incorporated, — see Holland *v.* Lee, 71 Md. 338; *s. c.* 40 Am. & Eng. R. Cas. 379; 18 Atl. Rep. 661.

[2] Nashua &c. Corp. *v.* Boston &c. Corp., 136 U. S. 356; Coe *v.* East &c. R. Co., 52 Fed. Rep. 531; Leathers *v.* Janney, 41 La. An. 1120; *s. c.* 6 South. Rep. 884; Langan *v.* Francklyn, 20 N. Y. Supp. 404. That such a contract, like others of the same nature, is *validated by the unanimous consent* of the stockholders of the two contracting corporations, see Barr *v.* New York &c. R. Co., 125 N. Y. 263; *s. c.* 34 N. Y. St. Rep. 743; 43 Alb. L. J. 151; 9 Rail. & Corp. L. J. 174; 26 N. E. Rep. 145. And that, although voidable, it may be *ratified* by them, see Coe *v.* East &c. R. Co., 52 Fed. Rep. 531.

[3] McComb *v.* Barcelona Apartment Asso., 134 N. Y. 598; *s. c.* 45 N. Y. St. Rep. 784; 31 N. E. Rep. 613.

such a contract were void *ab initio* as between the two corporations, it would be void as to the other parties to it.

§ 4080. Contract not Voidable if there be a Quorum of Directors not Directors in Both Corporations.—We may conclude further that if a contract is entered into between two corporations, some of the directors of one of which are also directors of the other, the contract will not be voidable, in the absence of fraud, if there is a quorum of directors in both corporations who are not rendered incompetent to act by reason of being directors in both companies.[1]

§ 4081. Opposing View that Such Contracts are Voidable. A contrary and better view is that such contracts are voidable, although there was a quorum in each board of directors who were not directors in the other. This view is founded upon experience, and rests upon the well-known opportunities for fraud which exist where all the members of each contracting body are not in a situation to think and act freely for their own constituents, without being swayed by any considerations in behalf of the other, and upon the right of those directors who are disinterested to be able to consult with a full board whose allegiance, like their own, is clear.[2] Accordingly, it has been held that a contract between a railroad and a construction company is void, in the sense that it cannot be made the foundation for equitable relief, when any of the directors of the railroad company are members of the construction company; and that the fact of long acquiescence on the part of the stockholders of the railroad company makes no difference.[3]

[1] United States Rolling Stock Co. *v.* Atlantic &c. R. Co., 34 Ohio St. 450; *s. c.* 32 Am. Rep. 380. See also Booth *v.* Robinson, 55 Md. 419; Flagg *v.* Manhattan R. Co., 10 Fed. Rep. 413.

[2] Metropolitan Elevated Ry. Co. *v.* Manhattan Elevated R. Co., 11 Daly (N. Y.), 373; *s. c.* 14 Abb. N. Cas. (N. Y.) 103.

[3] Thomas *v.* Brownville &c. R. Co., 109 U. S. 522; affirming on this point *s. c.* 1 McCrary (U. S.), 392, and 2 Fed. Rep. 887. It appeared that the directors of the railroad company received a pecuniary consideration for the contract. See also Barr *v.* New York &c. R. Co., 5 N. Y. Supp. 623; *s. c.* 52 Hun (N. Y.), 555 (where one of these "Credit Mobilier" arrangements was set aside); also Bunnel *v.* Empire Laundry Machinery Co., 24 N. Y. St. 675; *s. c.* 5 N. Y. Supp. 591.

§ 4082. Voidable where the Same Persons are Directors in Both Corporations.—Clearly, a contract between two corporations is voidable in equity, at the suit of either corporation or its representative, where the same persons were directors in both corporations.[1]

§ 4083. Voidable where the Sole Contracting Agent is an Officer in Both Corporations.—Following out the principle that an agent cannot act in a double and antagonistic capacity, in which his personal interests are opposed to that of his principal,[2] it has been well held that where a note is made by the directors of one corporation as individuals, and transferred to another corporation, but one of the makers, who figures as payee and indorser, is the *president of both corporations,*—the latter cannot consent to any arrangement releasing or impairing the individual liability of himself or his co-directors.[3]

§ 4084. Corporate Agent Employed by the Other Contracting Party.—Although the law does not permit the agent of a corporation to serve two masters, it has been held that an insurance agent, who is also employed by the owner of property to watch it, may bind the company by a policy of insurance thereon.[4]

§ 4085. Such Contracts Validated by Acquiescence and Ratification.—Such contracts being *valid at law,* and only *voidable in equity,* even where a majority of the directors of both companies are affected by this dual relation, may become valid by acquiescence and lapse of time, on the theory of a *ratification;* since the majority of the corporation, seeking to disaffirm, possess implied power to restrain and control the action of the minority, and if the contract is voidable at the

[1] Bill *v.* Western Union Tel. Co., 16 Fed. Rep. 14.

[2] Stevenson *v.* Bay City, 26 Mich. 44, 46.

[3] Gallery *v.* National Exchange Bank, 41 Mich. 169; *s. c.* 32 Am. Rep. 149.

[4] Northrup *v.* Germania Fire Ins. Co., 48 Wis. 420; *s. c.* 33 Am. Rep. 815.

option of the company, the majority have full power to express the company's election if they see fit to do so.[1]

§ 4086. Director or Officer may be Trustee in Corporate Mortgage. — An officer of a railroad company may legally become the trustee in a mortgage given by the company, to secure the payment of its bonds.[2] It is no objection to the trust deed of a corporation that one of the directors was made trustee, he also joining in executing the deed.[3]

§ 4087. Contract with Stockholder not Changeable by Corporation without His Consent. — The power of the corporation to contract with the stockholder being once conceded, it is plain that the contracting parties must be regarded as strangers to each other;[4] and therefore the contract will be unaffected by any action or vote of the corporation, unless assented to by the contracting party.[5] Corporations may also contract with each other, although the constituent members of each may be the same persons.[6]

[1] United States Rolling Stock Co. *v.* Atlantic &c. R. Co., 34 Ohio St. 450; *s. c.* 32 Am. Rep. 380. To this principle see Twin-Lick Oil Co. *v.* Marbury, 91 U. S. 587. That such contracts may be *ratified* by the stockholders, see Coe *v.* East &c. R. Co., 52 Fed. Rep. 531; Pneumatic Gas Co. *v.* Berry, 113 U. S. 322; Leavenworth County *v.* Chicago &c. R. Co., 134 U. S. 688; affirming *s. c.* 25 Fed. Rep. 219; and compare Thomas *v.* Brownsville &c. R. Co., 109 U. S. 522; affirming in part, *s. c.* 2 Fed. Rep. 877, and 1 McCrary (U. S.), 392; *post*, § 5314.

[2] Ellis *v.* Boston &c. R. Co., 107 Mass. 1.

[3] Bassett *v.* Monte Cristo &c. Mining Co., 15 Nev. 293.

[4] Hill *v.* Manchester &c. Co., 2 Nev. & M. 573; *s. c.* 5 Barn. & Adol. 866.

[5] American Bank *v.* Baker, 4 Met. (Mass.) 164; Longley *v.* Longley Stage Line Co., 23 Me. 39.

[6] Canal Bridge *v.* Gordon, 1 Pick. (Mass.) 297, 308; *s. c.* 11 Am. Dec. 170.

CHAPTER LXXIX.

GENERAL VIEW OF THE LIABILITY OF DIRECTORS.

SECTION
4090. *Status* of directors and general nature of their liability.
4091. Their twofold liability for nonfeasance and misfeasance.
4092. General view of the remedies given.
4093. Evidence of acquiescence to charge a particular director.
4094. Cases illustrating this question.

SECTION
4095. Liability joint or several.
4096. Director may be jointly liable with the corporation.
4097. Directors not necessarily liable for the frauds of subordinate agents appointed by them.
4098. What knowledge imputable to directors and officers.

§ 4090. Status of Directors and General Nature of their Liability. — In order to understand the liability of directors, it is necessary to consider the various relations which they occupy. In the courts of law they are generally viewed as *agents* of the corporation:[1] and with reference to this relation the corporation is, for certain purposes of convenience in the administration of justice, viewed as an artificial, intangible body, distinct from the aggregate body of its shareholders.[2] In the view of these courts, they stand towards the shareholders, whether considered separately or collectively, as mere strangers. In the courts of equity, which look more to the sense and substance than to the mere form of things, they are viewed as *trustees*, either of the corporation as an artificial body, or of the aggregate body of the shareholders.[3] It follows that, for any failure or violation of the duties which they have assumed towards the corporation, the latter will be able to

[1] Compare *ante*, § 3968.

[2] Bank of Augusta *v.* Earle, 13 Pet. (U. S.) 519, 587; Head *v.* Providence Ins. Co., 2 Cranch (U. S.), 127; Dartmouth College *v.* Woodward, 4 Wheat. (U. S.) 518, 636.

[3] Great Luxembourg R. Co. *v.* Magnay, 25 Beav. 586; Gaskell *v.* Chambers, 26 Beav. 360.

enforce against them in the courts of law such remedies as a principal may usually enforce against his agent. But at the same time, the shareholders have not, either individually or collectively, any remedies which they can enforce against the directors in the courts of law;[1] and the reason is, that there is no privity between the shareholders and directors, in the view of these courts. The directors are agents of the corporation, and not agents of the shareholders. Again, in the courts of equity, as well as in the courts of law, the corporation may enforce against the directors any remedies which a principal may ordinarily, in such a court, enforce against his agent; and if the corporation fails or refuses to enforce against unfaithful directors the remedies which it may have against them, one or more of the shareholders may, suing for themselves and the whole body of shareholders, claim the enforcement of suitable remedies in equity.[2] The courts of equity here support their jurisdiction upon the grounds of fraud or trust, as the case may be, coupled with the fact that there is no adequate remedy at law. A court of law turns a shareholder out of its doors when he sues the directors for a breach of their official duty, on the ground that they are not *his* officers, but the officers of the artificial body, the corporation. A court of equity opens its doors to receive him, on the ground that the unfaithful directors are his trustees, and for the further reason that he has been turned out of the court of law.

§ 4091. Their Twofold Liability for Non-feasance and Misfeasance. — Then, again, an agent is under a twofold liability for wrongs which he may do while acting in the course of his agency. 1. He is, as already stated, liable to his principal for breaches of the duties he has assumed towards him; or, as the books more briefly express it, for *non-feasance.* 2. He is also liable for trespasses, frauds, or other wrongs which he may commit against third persons while discharging the duties of his agency; or, as the books more briefly express it,

[1] Smith *v.* Hurd, 12 Met. (Mass.) 371; *s. c.* 46 Am. Dec. 690; Thomp. Off. Corp. 249.

[2] *Post*, § 4479.

for *misfeasance.* And he is none the less liable for acts of *misfeasance* from the fact that his principal may also be liable. If the wrong was done in the course of his agency, or if it was directly authorized by his principal, he and his principal may be both liable as joint *tort-feasors.*[1] Obviously an agent may also be liable to his principal for acts of *misfeasance,* the same as to a stranger. His liability may be, then, concisely stated to be this: For *non-feasance,* or for non-execution of the duties of his agency, he is liable only to his principal, or to some one claiming through his principal. For *misfeasance* or wrongs done in the course of his agency, whether within or without the scope of his authority, he is liable to the person injured, whether such person be his principal or a stranger. By keeping in mind these principles, we shall be able to get a clear idea of the liability to which directors of corporations may, for negligence, frauds, and other wrongs, subject themselves; to whom they may become liable, and the manner in which this liability may be enforced.

§ **4092. General View of the Remedies Given.** — *The company* itself has a remedy against its directors, for negligence, fraud, breaches of trust, or acts done in excess of their authority, either at law or in equity, according to the nature of the wrong done.[2] For acts of fraud or misfeasance, done by directors, whereby *shareholders* are injured, the latter have an action at law, on precisely the same grounds as other strangers would have.[3] Shareholders also have a remedy against directors for breaches of trust committed by the latter where the corporation refuses to pursue, for the shareholder, the proper remedy.[4] *Strangers* have any appropriate remedy against the directors of a corporation which one man may ordinarily have against another in the ordinary relations of civil society, not resting in contract.[5]

[1] Bruff *v.* Mali, 36 N. Y. 200, 205; New York &c. R. Co. *v.* Schuyler, 34 N. Y. 30; Phelps *v.* Wait, 30 N. Y. 78; Suydam *v.* Moore, 8 Barb. (N. Y.) 358; Salmon *v.* Richardson, 30 Conn. 360; *s. c.* 79 Am. Dec. 255.

[2] *Post,* § 4118.

[3] *Post,* § 4475.

[4] *Post,* § 4478.

[5] *Post,* § 4132, *et seq.*

§ **4093. Evidence of Acquiescence to Charge a Particular Director.**— What circumstances of direct acquiescence in the fraudulent or unlawful acts of the managing body, or of passive negligence in failing to oppose and thwart them, will be sufficient to charge a director, must be resolved according to the particular facts of each case. A director who was an original party to an unlawful scheme, whereby the funds of the company were dissipated, did not discharge himself from liability by showing that he afterwards went in and protested against it, and did nothing more. He should have called his colleagues together, laid before them his protest in a formal manner, and demanded action upon it; and, if necessary, he should have filed a bill to restrain the illegal action.[1] A director, who was not a party to the original unlawful transaction, but who signed a check, by which moneys of the company were disbursed, in pursuance of it, was in a situation no better. Such a director would not be heard to say that the signing of the check was a mere ministerial act, and that, at the time he signed it, he was really in ignorance of the nature of the transaction. In such cases the law will not excuse negligent ignorance. He being under a duty of knowing, his liability is the same as though he had done the act with full knowledge.[2] But a director, whose only fault was passive negligence, who paid no attention to the affairs of the company; who had but a vague notion of what was going on; who trusted everything to the other directors, confided in them, and took it for granted that everything was all right,— was held not jointly liable with the others, though his standing in a court of equity was so poor that he would be charged with the costs of the proceeding against himself.[3]

§ **4094. Cases Illustrating This Question.** — In another case, the directors of a company, part of whose business it was to make loans, appointed an executive committee. The committee, in order to raise the price of shares, bought shares in the name of the secretary and another, and, in order to pay for them, drew checks upon

[1] Joint-Stock Discount Co. *v.* Brown, L. R. 8 Eq. 381, 402.

[2] *Ibid.*, 404, 405 (Brown's case).

[3] *Ibid.* (Gillespie's case).

the bankers of the company. These checks were reported to a meeting of the directors as having been drawn for loans. They were approved by the directors, and the money was paid accordingly. There was evidence that the transaction was explained to some of the directors; but one of them was present during a part of the meeting only, and had no knowledge of the transaction. It was held, reversing the Master of the Rolls, that this director was not liable to repay the money.[1] The American codes of procedure, founded upon that of New York, blend together legal and equitable remedies; and, where one rule obtained in the courts of law, and a different rule in the courts of equity, they, it is believed, in most cases, preserve the rule of equity, and abolish the rule of law; the rules of the former tribunals being more flexible and better adapted to the attainment of exact justice. Accordingly we find the principle just stated, laid down and applied by the Court of Appeals of New York, in an action brought against the directors of a corporation by a creditor, who, as his petition alleged, had been induced to give credit to the company on fraudulent representations made by the directors as to its capital. As to one of the defendants there was no evidence connecting him with the fraud, except the mere fact that he had been named as a director and that one hundred shares of stock had been issued to him. Nevertheless, the court below refused a nonsuit as to him, but the Court of Appeals held this to be error. The court ruled that the mere fact of being a director was not *per se* sufficient to make a person liable for the frauds and misrepresentations of the active managers of a corporation. Some *knowledge* of and *participation* in the act claimed to be fraudulent, must be brought home to him. It is only when a director lends his name and influence to promote a fraud upon the community, or is guilty of some violation of law, or other misfeasance, that he is personally liable.[2] It was conceded that where men confederate together to create a fraudulent corporation for the purpose of swindling the public, the use of their names as directors by their consent would present a different question; and so it has been ruled.[3]

[1] Land Credit &c. Co. *v.* Fermoy, L. R. 5 Ch. 763; reversing *s. c.* L. R. 8 Eq. 7; 18 Week. Rep. 109; 23 L. T. (N. S.) 439.

[2] Arthur *v.* Griswold, 55 N. Y. 400.

[3] Hornblower *v.* Crandall, 7 Mo. App. 220; *s. c.* affirmed, 78 Mo. 581; Watson *v.* Crandall, 7 Mo. App. 233; *s. c.* affirmed, 78 Mo. 583.

§ **4095. Liability Joint or Several.**—In cases of this kind where the liability arises from the wrongful act of the parties, *each* is liable for all the consequences; there is no right of contribution among them,[1] though the case against each is distinct, depending upon the evidence against him. It is not, therefore, necessary to make all the directors parties who may have more or less joined in the act complained of.[2]

§ **4096. Director may be Jointly Liable with the Corporation.** — It is familiar doctrine in the law of agency that for acts of *misfeasance*, that is, for wrongs or frauds committed by an agent in the course of his agency, to the injury of a third person, such person may maintain an action *jointly* against the agent and his principal, or he may proceed severally against either.[3] In such cases it will be no defense for the agent to say, "my principal authorized the wrongful act." The law will hold the actor responsible and remit him to his principal for indemnity. This doctrine applies in cases of *frauds* committed by directors of corporations whereby third persons are injured. If the fraud is one imputable to the company, the person injured may maintain a bill in equity against the corporation and the directors for the reparation

[1] Merryweather *v.* Nixan, 8 T. R. 186; Peck *v.* Ellis, 2 Johns. Ch. (N. Y.) 131; Oakes *v.* Spaulding, 40 Vt. 347; *s. c.* 94 Am. Dec. 404; Spaulding *v.* Oakes, 42 Vt. 343. Unless the act which rendered the directors liable was not in itself illegal, but merely *ultra vires:* Ashhurst *v.* Mason, L. R. 20 Eq. 225. As to contribution where the liability is statutory, see *post*, § 4377.

[2] Attorney-General *v.* Wilson, 1 Craig & P. 1, 28; *s. c.* 10 L. J. (Ch.) 53; 4 Jur. 1174; 7 L. J. (Ch.) 6; Charitable Corporation *v.* Sutton, 2 Atk. 400; *s. c.* 9 Mod. 349; Land Credit Co. *v.* Fermoy, L. R. 5 Ch. 763; Franklin Fire Ins. Co. *v.* Jenkins, 3 Wend. (N. Y.) 130. Compare Beadles *v.* Burch, 10 Sim. 332; Consett *v.* Bell, 1 Younge & C. 569.

[3] Phelps *v.* Wait, 30 N. Y. 78; Wright *v.* Wilcox, 19 Wend. (N. Y.) 343; *s. c.* 32 Am. Dec. 507; Suydam *v.* Moore, 8 Barb. (N. Y.) 358; Montfort *v.* Hughes, 3 E. D. Smith (N.Y.), 591; Hewett *v.* Swift, 3 Allen (Mass.), 420. Some cases which make seeming exceptions to this rule were those in which the duty, the violation of which was laid as the foundation of the action, was owed by the agent *to his principal*, and not to the plaintiff. Campbell *v.* Portland Sugar Co., 62 Me. 552; *s. c.* 16 Am. Rep. 503. Parsons *v.* Winchell, 5 Cush. (Mass.) 592; *s. c.* 52 Am. Dec. 745,—denies the doctrine of the text.

of the injury,[1] and possibly an action at law would lie under similar circumstances. But it would be an action *ex contractu;* an action at law will not lie against a corporation for deceit.[2] If, on the other hand, an officer of a corporation directs or authorizes a tort to be committed by a servant of the corporation, he will be liable equally with the corporation.[3] This is analogous to the principle declared in many cases, that where the act which is the subject of the action is one of positive *misfeasance,* and not a mere omission of duty on the part of an agent, employé, or servant, the latter will be liable to a third person for injuries resulting therefrom, in like manner as the principal or master will be liable.[4] But it has been held that the president of a corporation is not liable to an action for a personal injury, merely by reason of the fact of his having transmitted an order of the corporation to a servant, who, in executing it, has used illegal force; otherwise, if the order has been issued by him on his own responsibility.[5] This is in conformity with the rule which exonerates an intermediate servant, where the injury has been committed by a servant subordinate to him under circumstances that would make the immediate actor and the ultimate principal liable.[6] For instance, the *selectman* of a town will not be liable for the trespass of a servant, unless he directed or authorized it.[7]

§ 4097. Directors not Necessarily Liable for the Frauds of Subordinate Agents Appointed by Them.—It is a rule in the law of agency that an agent is not liable for the wrongs committed by a subordinate agent appointed and controlled by

[1] Re National Bank, L. R. 10 Eq. 298.

[2] New Brunswick &c. R. Co. *v.* Conybeare, 9 H. L. Cas. 725, 740; Western Bank of Scotland *v.* Addie, L. R. 1 H. L. (Sc.) 145, 157.

[3] Peck *v.* Cooper, 112 Ill. 192; *s. c.* 54 Am. Rep. 231.

[4] Harriman *v.* Stowe, 57 Mo. 93. The distinction is taken by Lord Holt in the leading case of Lane *v.* Cotton, 12 Mod. 489; *s. c.* 1 Ld. Raym. 646, 655. See also Cary *v.* Webster, 1 Strange, 480; Montfort *v.* Hughes, 3 E. D. Smith (N. Y.), 591; Suydam *v.* Moore, 8 Barb. (N. Y.) 358; Phelps *v.* Wait, 30 N. Y. 78.

[5] Hewett *v.* Swift, 3 Allen (Mass.), 420. Compare Bath *v.* Caton, 37 Mich. 199.

[6] Stone *v.* Cartwright, 6 T. R. 411.

[7] Bacheller *v.* Pinkham, 68 Me. 253.

him, unless the evidence shows that he authorized the wrong, or in some way participated in it. The reason is that the agent doing the wrong is not his agent, but the agent of the common principal. The doctrine of *respondeat superior* does not apply to him, but to the principal. If the intermediate agent has been guilty of negligence in selecting an unfit subordinate agent, this is merely a breach of duty to his principal, for which he is answerable to him, and not to another person. This doctrine has been applied where the intermediate agent was a steward or manager of mines,[1] the president[2] or general agent[3] of a corporation, the selectman of a town,[4] and the captain of a vessel.[5] When, therefore, the directors of a company appointed certain brokers the agents of the company to sell, for the account of the company, certain debentures of the company, and the brokers, unknown to one of the directors, in order to effect the sale, put forth false and fraudulent statements concerning the standing of the company, whereby the plaintiff was deceived into investing in the debentures, which turned out to be worthless, it was held that the plaintiff could not maintain an action for the damages thus sustained, against this director.[6] But circumstances may exist which will charge the directors, although they did not know of the fraud at the time it was committed. This will happen where the directors personally and knowingly derived a benefit from the fraud. Here the subordinate agents who committed the fraud become in a sense the agents of the directors.[7]

§ 4098. What Knowledge Imputable to Directors and Officers.—The directors of a corporation are conclusively

[1] Stone *v.* Cartwright, 6 T. R. 411.

[2] Hewitt *v.* Swift, 3 Allen (Mass.), 420.

[3] Bath *v.* Caton, 37 Mich. 199.

[4] Bacheller *v.* Pinkham, 68 Me. 253.

[5] Nicholson *v.* Mounsey, 15 East, 384.

[6] Weir *v.* Barnett, 3 Ex. Div. 32; affirmed on appeal, 3 Ex. Div. 238.

[7] Upon these grounds in the case just cited some of the directors were charged and one of them discharged; but the learned judges were not altogether agreed in the reasons they gave for their conclusions, and Cotton, L. J., dissented from so much of the judgment as discharged the director who derived no personal benefit from the transaction.

chargeable with knowledge of the *statute* under which the corporation is organized and from which it derives its powers;[1] and, indeed, all persons who join a corporation are presumed to acquaint themselves with its constitution and by-laws.[2] Clearly, an *officer* and stockholder of a corporation is, by reason of his position, *prima facie* chargeable with knowledge of the *customs* and *usages* of the corporation;[3] though it has been held that a director, and for stronger reasons, a mere stockholder, is not chargeable, as matter of law, with actual knowledge of the *business transactions* of the corporation, or of the contents of its books and papers.[4] It seems to be a principle of the law that where several persons act *jointly*, whether in respect of their own business, or as agents for another, the knowledge acquired by one of them, *while so acting*, with reference to the subject-matter of their joint action, will be imputed to all.[5]

[1] Van Etten *v.* Eaton, 19 Mich. 187, 193. Therefore, their failure to make and publish a report required by such statute is *presumed* to have been *intentional. Ibid.*

[2] Belleville Mutual Ins. Co. *v.* Van Winkle, 12 N. J. Eq. 333.

[3] Fraylor *v.* Sonora &c. Co., 17 Cal. 594.

[4] Rudd *v.* Robinson, 126 N. Y. 113; 12 L. R. A. 473; *s. c.* 22 Am. St. Rep. 816; 9 Rail. & Corp. L. J. 428; 26 N. E. Rep. 1046; Briggs *v.* Spaulding, 141 U. S. 132. See *ante,* § 1081; *post,* § 5234. It has been held that notice to a corporation is notice to its officers in respect to defects in the *title* to *promissory notes transferred* by the corporation *to them.* Nelson *v.* Wellington, 5 Bosw. (N. Y.) 178.

[5] Lyman *v.* Bank of U. S., 12 How. (U. S.) 225; affirming *s. c.* 1 Blatchf. (U. S.) 297 (where certain directors made a *joint purchase,* and the knowledge of some was imputed to all). Compare Perry *v.* Simpson Waterproof Man. Co., 37 Conn. 520.

CHAPTER LXXX.

LIABILITY OF DIRECTORS FOR NEGLIGENCE.

SECTION
4100. Directors may be liable for negligence.
4101. Distinction, in respect of this liability, between discretionary and ministerial acts.
4102. Not liable for discretionary acts: liable for gross negligence in respect of ministerial duties.
4103. Not liable for mistakes of judgment.
4104. Bound to exercise ordinary business diligence.
4105. Such negligence judged by what standard: by judge or jury.
4106. Responsible for losses happening through gross negligence.

SECTION
4107. Their liability for the acts of subordinates.
4108. Their liability for negligent ignorance.
4109. Liability for negligent acts which are *ultra vires*.
4110. Effect of acquiescence on the part of the shareholders.
4111. Liability of directors for each other's acts.
4112. Liability of *ex officio* members for each other's acts.
4113. Application of these principles to banking corporations.
4114. Indictment of directors for negligent failure to perform official duties.

§ 4100. Directors may be Liable for Negligence.—Subject to the qualifications hereafter stated,—qualifications which render the rule of little value to stockholders or creditors,—the directors of a corporation are bound to administer its affairs according to the terms of its charter or governing statute, with diligence and in good faith; and if they fail in either respect they are liable to the party in interest who is injured by it, for a breach of trust, and may be made to account with him in a court of chancery.[1] It has been said that if they neglect to perform the acts which are within their authority, and which they ought to perform, neither a court

[1] Hodges *v.* New England Screw Co., 1 R. I. 312; *s. c.* 53 Am. Dec. 624; Bank of St. Mary's *v.* St. John, 25 Ala. 566. Compare Patteson *v.* Baker, 34 How. Pr. (N. Y.) 180; and Winter *v.* Baker, 34 How. Pr. (N. Y.) 183. There is a valuable note on this subject in 28 Cent. L. J. 286.

of law nor of equity will allow them afterwards to take advantage of their own neglect.[1] They are, therefore, liable, affirmatively or negatively, to some extent at least, for losses happening through their negligence. Statutes have frequently been enacted in confirmation of this principle.[2]

§ **4101. Distinction, in Respect of This Liability, between Discretionary and Ministerial Acts.**—In respect of the liability of the directors, trustees, or other managing board of a corporation for negligence, we may take a distinction between acts done by such officers in their *judicial* or *legislative* capacity (if such expressions may properly be used), as to which they are called upon to exercise a *discretion,* and acts which are merely *ministerial.* This distinction is of constant application in determining the liability of municipal corporations,[3] and public officers[4] for negligence; though it is not much resorted to in the cases of directors of private corporations. For mere errors of judgment by the officers of a private corporation, by which damage has been done to a member of a corporation, an action at law does not lie; for, to give such an action would be to destroy the discretion vested in them, by making it subject to revision in the judicial courts. To warrant such an action it must appear that the act complained of was *willful* and *malicious,* and done for the purpose of injuring the plaintiff.[5] When, therefore, certain officers of a corporation, sitting as jurors, according to the constitution of the company, forfeited the franchises of one of the members of the company on account of his refusal to pay a fine which had been levied upon him, it was held that an action for the damages thus inflicted upon him would not lie, although the proceeding which resulted in the forfeiture was irregular, so much so that the court of Queen's bench had awarded a *mandamus* to restore the plaintiff to his privileges; the ground of

[1] Bargate *v.* Shortridge, 5 H. L.Cas. 297; *s. c.* 24 L. J. Ch. 457.

[2] See for example, Rev. Stats. Ohio, 1880, § 3314.

[3] 2 Thomp. Neg., p. 731.

[4] 2 Thomp. Neg., p. 815.

[5] Harman *v.* Tappenden, 1 East, 555.

the decision being that the proceedings which resulted in the forfeiture involved simply a mistake to which no malicious motives were imputable.[1] The liability of such officers for official acts which result in injuries to members, is closely analogous to that of judges of elections; and in the case cited, Lord Kenyon quoted from such a case, and based his reasoning upon it.[2]

§ 4102. Not Liable for Discretionary Acts: Liable for Gross Negligence in Respect of Ministerial Duties. — With respect to the liability of the directors of a corporation to the corporation itself, it is supposed that we must recur, for the solution of all questions which may arise, to the general doctrines which govern the liability of agents and mandataries. It is also supposed that these rules, being rules of right, and not rules of procedure, are equally and uniformly applied, whether the question arises in a court of law or in a court of equity. It cannot be that, in respect of a matter which so vitally concerns the interests of men engaged in mercantile pursuits, there is one rule of right in a court of law, and another rule of right in a court of equity. We, therefore, find substantially the same rules applied in Godbold *v.* Branch Bank of Mobile,[3] which was an action at law by a corporation against its directors for negligence, and in Spering's Appeal,[4] which was a bill in equity by the trustee of an insolvent corporation to charge the directors on the same ground. These rules are: 1. Where directors are clothed with a *discretion*, they are not responsible to the corporation for damages flowing from an exercise of this discretion, however erroneous their exercise of it may have been. 2. In respect of their *ministerial* duties, they are not responsible to the corporation

[1] Harman *v.* Tappenden, 1 East, 555.

[2] Namely, the case of Drewe *v.* Coulton, set out in the note in 1 East, 563. On the same ground the insurance commissioner of a State is not personally liable for refusing to grant a company a license to do business unless he acts corruptly, his action being *judicial*. State *v.* Thomas, 88 Tenn. 491; *s. c.* 12 S. W. Rep. 1034.

[3] 11 Ala. 191; *s. c.* 46 Am. Dec. 211.

[4] 71 Pa. St. 11, 24; *s. c.* 10 Am. Rep. 684.

for anything short of gross negligence, non-attendance, and fraud, whereby frauds have been perpetrated, or the property of the corporation embezzled or wasted.[1] The leading case establishing this doctrine is Colt *v.* Woollaston.[2] An able exposition of it is also found in Percy *v.* Millaudon,[3] which is a case of high authority.[4]

§ **4103. Not Liable for Mistakes of Judgment.** — As the directors impliedly stipulate with the stockholders to give no more than good faith and ordinary or reasonable care,[5] it follows that they are not liable for losses happening through mere *mistakes of judgment*, whether in respect of discretionary or ministerial matters.[6] It has been said that they are not liable for mistakes of judgment although so gross as to appear absurd, if honest and within the scope of their powers, —especially when acting under the advice of counsel.[7] It has also been said that, to render them liable, the acts must be so grossly wrong as to warrant the imputation of fraud, or the want of the necessary knowledge for the performance of the duty assumed by them, on accepting the agency.[8] Therefore no recovery can be had against the directors of a bank for losses sustained by mere errors in judgment in purchasing under execution and foreclosure sales, in an attempt to

[1] Henry *v.* Jackson, 37 Vt. 431, is also a good illustration of the rule stated in the text. To the same effect, see Smith *v.* Prattville Man. Co., 29 Ala. 503; Neall *v.* Hill, 16 Cal. 145, 151; *s. c.* 76 Am. Dec. 508.

[2] 2 P. Wms. 154.

[3] 8 Mart. (N. S.) 68.

[4] It is quoted with approval in Story on Bailments, § 173 *a;* Whart. on Neg., § 510, and in Steamboat New World *v.* King, 16 How. (U. S.) 469.

[5] *Post,* § 4104.

[6] Wallace *v.* Lincoln Savings Bank, 89 Tenn. 630; *s. c.* 24 Am. St. Rep. 625; 9 Rail. & Corp. L. J. 482; 15 S. W. Rep. 448; 4 Bkg. L. J. 249; Spering's Appeal, 71 Pa. St. 11; *s. c.* 10 Am. Rep. 684; Thomp. Off. Corp. 233; Briggs *v.* Spaulding, 141 U. S. 132; Smith *v.* Prattville Man. Co., 29 Ala. 503; Witters *v.* Sowles, 31 Fed. Rep. 1; Hodges *v.* New England Screw Co., 1 R. I. 312; *s. c.* 53 Am. Dec. 624; *s. c.* on second appeal, 3 R. I. 9; Godbold *v.* Branch Bank, 11 Ala. 191; *s. c.* 46 Am. Dec. 211; Re New Mashonaland Exploration Co. [1892] 3 Ch. 577; Overend & Gurney Co. *v.* Gibb, L. R. 5 H. L. 480; affirming *s. c.* L. R. 4 Ch. 701.

[7] Spering's Appeal, *supra.*

[8] Godbold *v.* Branch Bank, 11 Ala. 191; *s. c.* 46 Am. Dec. 211.

save debts due the bank.[1] Nor can directors of a national bank be made liable for the debts of a bank, for an error or misstatement innocently made by him in a *report* of the condition of the bank;[2] nor for losses to the bank, caused by *declaring dividends* based on an error of judgment as to the value of assets; nor for losses on loans and discounts made in good faith but resulting in loss;[3] nor for making investments on doubtful or insufficient security;[4] nor for purchasing under execution and foreclosure sales in attempting to save the debts due to the corporation;[5] nor for the failure of a bank in which they deposit funds of the corporation in good faith and which was in good credit at the time;[6] nor for failing to require their president to furnish a bond to secure the faithful discharge of his official duties.[7]

§ **4104. Bound to Exercise Ordinary Business Diligence.**— The measure of care, skill, and diligence required of the directors of a corporation is, stated generally, such as a prudent man exercises in the conduct of his own affairs, and this must be determined in each case in view of all the circumstances.[8] While, as hereafter seen, a class of decisions places the liability of directors under this head on a ground more favorable to them, by restraining it to cases of gross and habitual negli-

[1] Wallace *v.* Lincoln Savings Bank, 89 Tenn. 630; *s. c.* 24 Am. St. Rep. 625; 9 Rail. & Corp. L. J. 482; 15 S. W. Rep. 448; 4 Bkg. L. J. 249.

[2] Briggs *v.* Spaulding, 141 U. S. 132.

[3] Witters *v.* Sowles, 31 Fed. Rep. 1.

[4] North Hudson Mut. &c. Asso. *v.* Childs, 82 Wis. 460; *s. c.* 33 Am. St. Rep. 57; 52 N. W. Rep. 600; Williams *v.* McDonald, 37 N. J. Eq. 409; Williams *v.* Halliard, 38 N. J. Eq. 373.

[5] Wallace *v.* Lincoln Savings Bank, 89 Tenn. 630; *s. c.* 24 Am. St. Rep. 625; 9 Rail. & Corp. L. J. 482; 4 Bkg. L. J. 249; 15 S. W. Rep. 448.

[6] Stewart *v.* Lee &c. Asso., 64 Miss. 499; *s. c.* 1 South. Rep. 743.

[7] Williams *v.* Halliard, 38 N. J. Eq. 373.

[8] Scott *v.* Depeyster, 1 Edw. Ch. (N. Y.) 513; Hun *v.* Cary, 82 N. Y. 65; *s. c.* 37 Am. Rep. 546; Brinkerhoff *v.* Bostwick, 88 N. Y. 52; Marshall *v.* Farmers' &c. Bank, 85 Va. 676; *s. c.* 17 Am. St. Rep. 84; Bank *v.* Hill, 56 Me. 385; *s. c.* 96 Am. Dec. 470; Savings Bank *v.* Caperton, 87 Ky. 306; *s. c.* 12 Am. St. Rep. 488; Williams *v.* McKay, 40 N. J. Eq. 189; *s. c.* 53 Am. Rep. 775; Delano *v.* Case, 121 Ill. 247; *s. c.* 2 Am. St. Rep. 81; 17 Ill. App. 531; Corbett *v.* Woodward, 5 Sawyer (U. S.), 403, 416.

gence, non-attendance, and inattention to their duties,[1] yet none of the decisions exact more than reasonable business knowledge and skill, strict good faith, and a reasonable measure of care and diligence under the circumstances of the particular case.[2] Although being engaged in the management of what is partly and sometimes wholly their own property, they generally serve without compensation, and do not impliedly engage to give their whole time to the service, yet the measure of care required of them is no doubt that of an *ordinary bailee for hire*, and not that of an *insurer* of the property coming into their hands. This follows from the principle that they are *agents* of the corporation; and this is the measure of liability imposed upon the ministerial officers and agents of corporations, and also upon the agents of natural persons who receive a compensation for their services.[3] Directors of a *bank*, for instance, must exercise ordinary care and prudence in the administration of the affairs of the bank—such degree of care as ordinarily prudent and diligent men would exercise; and in determining this, the restrictions of the statutes and the usages of business are to be taken into account.[4] Another court says that reasonable conformity to the customs and methods in vogue among prudent bankers is the degree of diligence required of them.[5] This rule of lia-

[1] *Post*, § 4106.

[2] Smith *v.* Prattville Man. Co., 29 Ala. 503; Hodges *v.* New England Screw Co., 1 R. I. 312; *s. c.* 53 Am. Dec. 624; 3 R. I. 9; Godbold *v.* Branch Bank, 11 Ala. 191; *s. c.* 46 Am. Dec. 211; Spering's Appeal, 71 Pa. St. 11; *s. c.* 10 Am. Rep. 684; Thomp. Off. Corp. 233. Compare United Soc. *v.* Underwood, 9 Bush (Ky.), 609; *s. c.* 15 Am. Rep. 731.

[3] Such is the measure of liability imposed upon the *secretary* of a *building association:* Mowbray *v.* Antrim, 123 Ind. 24; *s. c.* 20 N. E. Rep. 858. Upon an *executor* or *administrator* in respect of the investment of the estate: Norwood *v.* Harness, 98 Ind. 134; *s. c.* 49 Am. Rep. 739, and many cases there cited. Upon the *guardian* of the estate of an infant: Slauter *v.* Favorite, 107 Ind. 291; *s. c.* 57 Am. Rep. 106; State *v.* Greensdale, 106 Ind. 364; *s. c.* 55 Am. Rep. 753. And upon an *attorney* in respect of the custody of money collected for his client: Naltner *v.* Dolan, 108 Ind. 500; *s. c.* 58 Am. Rep. 61.

[4] Briggs *v.* Spaulding, 141 U. S. 132; *s. c.* 10 Rail. & Corp. L. J. 62; 5 Bkg. L. J. 41.

[5] Wallace *v.* Lincoln Savings Bank, 89 Tenn. 630; *s. c.* 24 Am. St. Rep. 625; 9 Rail. & Corp. L. J. 482; 15 S. W. Rep. 448.

bility exonerates the directors from mere *mistakes* of judgment, on the one hand,[1] and leaves them liable for *gross negligence* on the other.[2] In legal nomenclature the expressions "*reasonable care*" and "*ordinary care*" are generally regarded as meaning the same thing; and it was evidently upon this conception that a majority of the Supreme Court of Illinois held that bank directors are trustees for the depositors as well as for the stockholders, and in the exercise of their trust are bound to the observance of ordinary care and diligence, and are hence liable for losses resulting from the non-observance of such care and diligence.[3] In like manner, the Supreme Court of Tennessee have reasoned that the diligence required of directors of corporations in the discharge of their duties is that exercised by prudent men in their own affairs, being that degree of diligence characterized as ordinary.[4]

§ 4105. Such Negligence Judged by What Standard—By Judge or Jury.—In all these cases, then, the question is, have directors been guilty of negligence of a gross and flagrant character? Whether they have or not, must always be a question of fact depending upon the circumstances of each case.[5] No rule can, therefore, be laid down by which to solve it. But, whilst this is true, it is none the less true that some standard ought, if possible, to be adopted for a guide in solving it. This standard, obviously, ought not to be the exacting standard of the legal scholar. Still less, perhaps, ought it to be the standard of the chancellor, whose whole official life has been a course of dealing with business failures, and insolvent corporations. It ought to be the *standard of business and financial men*, who understand and appreciate the hopes, the motives, and the surroundings, with which such ventures are

[1] *Ante*, § 4103.

[2] *Post*, § 4106.

[3] Delano *v.* Case, 121 Ill. 247; *s. c.* 2 Am. St. Rep. 81; 12 N. E. Rep. 676.

[4] Wallace *v.* Lincoln Savings Bank, 89 Tenn. 630; *s. c.* 24 Am. St. Rep. 625. Similarly, see Savings Bank *v.* Caperton, 87 Ky. 306; *s. c.* 12 Am. St. Rep. 488; 8 S. W. Rep. 885; Williams *v.* McKay, 40 N. J. Eq. 189; *s. c.* 53 Am. Rep. 775.

[5] Wallace *v.* Lincoln Sav. Bank, 89 Tenn. 630; *s. c.* 24 Am. St. Rep. 625.

gone into. More briefly, the standard of care required, ought to be the business man's standard of care, and not the standard of the student, or of the judge. This view was well brought out by Lord Hatherley, L. C., in the case we have been considering,[1] in explaining his judgment in another case,[2] where he said: "What I did intend to state in that case was, that I could not measure—and I think it would be a very fatal error in the verdict of any court of justice to attempt to measure—the amount of prudence that ought to be exercised, by the amount of prudence which the judge himself might think, under similar circumstances, he should have exercised. I think it extremely likely, that many a judge, or many a person versed by long experience in the affairs of mankind, as conducted in the mercantile world, will know that there is a great deal more trust, a great deal more speculation, and a great deal more readiness to confide in the probabilities of things, with regard to success in mercantile transactions, than there is on the part of those whose habits of life are entirely of a different character. It would be extremely wrong to import into the consideration of the case of a person acting as a mercantile agent in the purchase of a business concern, those principles of extreme caution which might dictate the course of one who is not at all inclined to invest his property in any ventures of such a hazardous character." These views emphasize the importance of trying such a suit by a *jury*, assuming, of course, that a suitable jury can be obtained to try it. And it is believed that where the issue is simply one of negligence, and the element of fraud does not come in, a chancellor ought, if the practice of his court will warrant it, and if a suitable jury can be obtained, always to take the advice of a jury before coming to a decision.[3]

§ 4106. Responsible for Losses Happening through Gross Negligence. — Directors of a corporation are personally liable

[1] Overend & Gurney Co. *v.* Gibb, L. R. 5 H. L. 494.

[2] Turquand *v.* Marshall, L. R. 4 Ch. 376.

[3] This was done in Hedges *v.* Paquett, 3 Or. 77.

for suffering the corporate funds or property to be wasted or lost by gross negligence or inattention to their duties.[1] Bank directors may, it is said, commit the banking business to their duly authorized officers; but this does not absolve them from the duty of *reasonable supervision;* nor ought they to be shielded from liability because of want of knowledge of wrong-doing, if that ignorance is the result of gross inattention.[2] It is said that directors, by assuming office, agree to give as much of their time and attention to its duties as the proper care of the interests intrusted to them may require. If they are inattentive to those duties, neglecting to attend meetings of the board, and turning over the management of the corporate business to the exclusive control of other agents, they are guilty of gross negligence with respect to their ministerial duties, and liable, if loss results to the corporation from breaches of trust or acts of negligence committed by those left in control, and which by due care and attention on their part such directors might have avoided.[3] Whatever doubt there may be upon the question whether directors, who generally serve without a salary, and who are consequently in a sense *gratuitous bailees,* are liable for the want of ordinary care, all judicial holdings agree in charging them with personal liability for that *gross and habitual negligence and non-attendance,* which is tantamount to the *crassa negligentia* of the civil law, and which is justly held to be a breach of the trust which they have assumed.[4] It is plain that the expression "*gross negligence*" is loosely used in many of the judicial decisions, and that it is sometimes used as the mere antithesis of a want of ordinary care,[5] and the rule seems to be the same in section 165 of the English Companies Act 1862, which makes them liable on a winding up of the company,

[1] Horn Silver Min. Co. *v.* Ryan, 42 Minn. 196; *s. c.* 44 N. W. Rep. 56; Hun *v.* Cary, 59 How. Pr. (N. Y.) 426, 439; *s. c.* affirmed in 82 N. Y. 65; 37 Am. Rep. 546.

[2] Briggs *v.* Spaulding, 141 U. S. 132.

[3] Wallace *v.* Lincoln Savings Bank, 89 Tenn. 630; *s. c.* 24 Am. St. Rep. 625.

[4] Trustees *v.* Bosseiux, 3 Fed. Rep. 817; *s. c.* 4 Hughes (U. S.), 387.

[5] It was so used in the language of the court in Hun *v.* Cary, 82 N. Y. 65; *s. c.* 37 Am. Rep. 546.

if it appear that they have been "guilty of any *misfeasance* or *breach of trust* in relation to the company." Under this statute the directors are not chargeable with liability for negligence, it is said, unless it has been *crassa negligentia* resulting in loss.[1] Aside from the provisions of the statute law, the rule of the English court of chancery, founded upon a decision of Lord Hardwicke rendered in 1742, which is the foundation of all the subsequent law on the subject, places the liability of directors upon the footing of "*gross non-attendance and neglect of duty*," which was held *tantamount to a breach of trust*. The decision contains such expressions as "supine negligence," . . . . "by which a gross complicated loss happened"; and the civil law expression *crassa negligentia* is used as furnishing the measure of their liability.[2] Sir N. Lindley, in speaking of their liability under this head, uses the expression "culpable negligence" or "willful default."[3] In one case the directors were held liable for losses sustained by their neglect in not causing the *business* of the company to be *stopped*, pursuant to a provision to that effect in its articles;[4] but where, under similar circumstances, the shareholders had sanctioned a continuance of the business, the conclusion was different.[5]

§ 4107. Their Liability for the Acts of Subordinates.— Directors of corporations may and must commit the perform-

[1] Re Liverpool Household Stores Asso., 62 L. T. (N. S.) 873; *s. c.* 8 Rail. & Corp. L. J. 227. Other cases decided under this statute are: Re British Guardian Life Assurance Co., 14 Ch. Civ. 335 (directors held liable for breach of trust); Re National Assurance Co., 10 Ch. Div. 118 (directors held liable for making payments to the shareholders out of the capital, the act being *ultra vires* and in breach of their trust); Re Forest of Dean Coal Min. Co., 10 Ch. Div. 450 (directors not liable on the ground of willful default or misfeasance for failing to take steps to recover promotion-money improperly paid).

[2] Charitable Corp. *v.* Sutton, 2 Atk. 400; *s. c.* Thomp. Off. Corp. 226. See also Overand *v.* Gibb, L. R. 5 H. L. 480; Evans *v.* Coventry, 2 Jur. (N. S.) 557; *s. c.* on appeal, 8 De Gex, M. & G. 835.

[3] Lind. Comp. Law (5th ed.), 372.

[4] Western Bank *v.* Bairds, cited in L. R. 4 Ch. 381; and in Lind. Comp. Law (5th ed.), 373.

[5] Turquand *v.* Marshall, L. R. 4 Ch. 376; reversing *s. c.* L. R. 6 Eq. 112. See also Lethbridge *v.* Adams, L. R. 13 Eq. 547.

ance of the ministerial work of the corporation to subordinate agents appointed by them; and, as already seen,[1] they are not liable for the acts of such agents on the principle of *respondeat superior*. They are not insurers of the fidelity of the agents whom they appoint, but if they act in good faith and with reasonable care and diligence in the *appointment* and *supervision* of such agents, they are not personally liable for losses happening through their frauds, their negligence, or their crimes.[2] But it seems clear on principle that if they *wrongfully delegate* their *discretionary duties* to an inferior ministerial officer,[3] he becomes their *alter ego*, — their right hand; so that, as between themselves and the corporation or its creditors, they make themselves insurers of his fidelity and responsible for his negligence, under the principle of *respondeat superior*. In a negative recognition of this principle, it has been held that where the directors of a bank commit the exclusive charge of *loans* and *discounts* to the cashier,[4] they become liable for losses only in case *he* is shown to have been negligent.[5] On the other hand, if the directors of a bank leave the custody, control, and management of its securities and property to a single officer, no matter how high may be his character and reputation, for a long space of time, without supervision, examination, or inquiry, they are guilty of negligence in the performance of *their* duty.[6] And although it is said to be proper for the managers of a savings bank to define the duties of the bank officers, and, in order to facilitate

[1] *Ante*, § 4097.

[2] Scott *v.* Depeyster, 1 Edw. Ch. (N. Y.) 513; Briggs *v.* Spaulding, 141 U. S. 132; Dunn *v.* Kyle, 14 Bush (Ky.), 134; Clews *v.* Bardon, 36 Fed. Rep. 617; Wallace *v.* Lincoln Savings Bank, 89 Tenn. 630; *s. c.* 24 Am. St. Rep. 625.

[3] As to the *delegation* of their duties by directors, see *ante*, § 3944, *et seq.*

[4] That this duty cannot be delegated, see *ante*, § 3948.

[5] Wallace *v.* Lincoln Savings Bank, 89 Tenn. 630; *s. c.* 24 Am. St. Rep. 625; 9 Rail. & Corp. L. J. 482; 15 S. W. Rep. 448; 4 Bkg. L. J. 294.

[6] Ouderkirk *v.* Central Nat. Bank, 119 N. Y. 263; *s. c.* 29 N. Y. St. Rep. 573; 23 N. E. Rep. 875 (where the question was as to the liability *of a bank* for the loss of bonds deposited with it).

the transaction of business, to appoint small *committees*[1] to superintend such officers and dispose of ordinary routine work, they are not authorized to relax vigilance and rely entirely upon such officers and committees.[2] In judging of their liability, it must be kept in mind that they are not expected to devote all their time to the management of the corporation, but that the customary method in regard to such associations is to commit the active management and responsibility to the custody of the cashier and other agents to whom salaries are paid, and whose entire time is demanded in the discharge of their duties, — the office of the directors being, in their character of part proprietors and mandataries, to superintend, direct, and control; and that the ground of their liability under the head of negligence and non-feasance consists in their *failure to exercise due diligence* in this work of supervision and control: the question being judged according to the circumstances of each particular case.[3]

[1] Compare, *ante*, § 3952.

[2] Williams *v.* McKay, 46 N. J. Eq. 52; *s. c.* 18 Atl. Rep. 824.

[3] Wallace *v.* Lincoln Savings Bank, 89 Tenn. 630; *s. c.* 24 Am. St. Rep. 625. Instances of *non-liability* under the foregoing rules: For *overdrafts* allowed by cashier without knowledge of directors and in violation of instructions: Wallace *v.* Lincoln Savings Bank, 89 Tenn. 630; *s. c.* 24 Am. St. Rep. 625; 9 Rail. & Corp. L. J. 482; 15 S. W. Rep. 448; 4 Bkg. L. J. 249. For insolvency through *discounting* paper not properly secured though indorsed by a wealthy director: Movius *v.* Lee, 30 Fed. Rep. 298; *s. c.* affirmed *sub. nom.* Briggs *v.* Spaulding, 141 U. S. 132. For losses through *frauds* and *forgeries* of the *secretary*, continued two or three years: Scott *v.* Depeyster, 1 Edw. Ch. (N. Y.) 513. For paying an *excessive price* for work done for the corporation in an emergency: Ward *v.* Davidson, 89 Mo. 445. For *voting compensation* to another director for extra services: Godbold *v.* Branch Bank, 11 Ala. 191; *s. c.* 46 Am. Dec. 211. For allowing debts due the corporation to become *barred* by the statute of *limitations:* Wallace *v.* Lincoln Savings Bank, 89 Tenn. 630; *s. c.* 24 Am. St. Rep. 625; 9 Rail. & Corp. L. J. 482; 15 S. W. Rep. 448; 4 Bkg. L. J. 249. For allowing the president of the corporation, it being a bank, to remain in its exclusive charge and management: Briggs *v.* Spaulding, 141 U. S. 132; *ante*, § 3948. For not making any investigation for ninety days after becoming directors: *Ibid.* For failing to keep the property of the corporation *insured:* Charlestown Boot & Shoe Co. *v.* Dunsmore, 60 N. H. 85. For mistakes of judgment and mismanagement in making investment of the company's funds on doubtful and insufficient security under the temptation of realizing for the

§ **4108. Their Liability for Negligent Ignorance.**—Where there is *a duty of finding out and knowing*, negligent ignorance has the same effect in law as actual knowledge.[1] While the directors of a corporation may and must, as already stated, commit the details of its business to inferior officers,[2] this does not absolve them from the duty of maintaining *a reasonable supervision*, and if such inferior officers waste the assets of the corporation, it is conceded that the directors cannot escape liability on the ground that they did not know of the wrong-doing, provided that it appear that their ignorance was the result of a want of that care which ordinarily prudent and diligent men would exercise under similar circumstances.[3] We have seen that directors are bound to exercise ordinary and reasonable care, which is synonymous with good business diligence. The antithesis of this degree of care and diligence is not gross inattention, but it is *ordinary negligence*—negli-

company large profits at usurious rates of interest: Spering's Appeal, 71 Pa. St. 11; *s. c.* 10 Am. Rep. 684; Thomp. Off. Corp. 233. For failing to take a *new bond* from their *secretary* upon his being *re-elected*, under the erroneous supposition that his old bond would continue good, and this although they took no legal advice: Vance *v.* Phœnix Ins. Co., 4 Lea (Tenn.), 385. For subscribing in the name of the corporation for shares of stock of another corporation: Hodges *v.* New England Screw Co., 1 R. I. 312; *s. c.* 53 Am. Dec. 624; on petition for review, 3 R. I. 9; Thomp. Off. Corp. 259, 280. For failing to detect fraudulent entries made by the cashier, though extending over a period of nine years: Savings Bank *v.* Caperton, 87 Ky. 306; *s. c.* 12 Am. St. Rep. 488; 8 S. W. Rep. 885; 4 Rail. & Corp. L. J. 153. The case was, upon *merging* one bank into another, for permitting the *president* of the new bank to use the *books* of the old firm in making the transfer to a new set of books, the president being a *defaulter*, but unknown to the directors: *Ibid.* For allowing the same person to act as *cashier*, *book-keeper*, and *teller: Ibid.* For making a single purchase of *United States bonds* to enable the corporation to avoid *taxation:* McNab *v.* McNab &c. Man. Co., 41 N. Y. St. Rep. 906; *s. c.* 16 N. Y. Supp. 448.

[1] 2 Thomp. Neg., p. 762.

[2] *Ante*, §§ 3947, 4097, 4107.

[3] Briggs *v.* Spaulding, 141 U. S. 132; Vance *v.* Phœnix Ins. Co., 4 Lea (Tenn.), 385; Williams *v.* McKay, 40 N. J. Eq. 189; *s. c.* 53 Am. Rep. 775; Delano *v.* Case, 121 Ill. 247; *s. c.* 2 Am. St. Rep. 81; 7 Ill. App. 531; Brinkerhoff *v.* Bostwick, 88 N. Y. 52; Corbett *v.* Woodward, 5 Sawyer (U.S.), 403, 416; Bank *v.* Hill, 56 Me. 385; *s. c.* 96 Am. Dec. 470; Hun *v.* Cary, 82 N. Y. 65; *s. c.* 37 Am. Rep. 546; Ackerman *v.* Halsey, 37 N. J. Eq. 356; Trustees *v.* Bosseiux, 3 Fed. Rep. 817; *s. c.* 4 Hughes (U. S.), 387.

gence without any intensifying epithet. Gross inattention, on the other hand, is the antithesis of slight attention, just as gross negligence is the antithesis of slight care. The true theory disregards the subtile and impracticable distinction between ordinary negligence and inattention and gross negligence and inattention, and holds directors responsible for not knowing that of which they had the means of knowledge; and, while relieving them from the responsibilities of insurers, ascribes liability on the ground of ignorance of that which could have been discovered by that good business diligence which is incumbent upon them.[1] Under this rule, directors who, by their negligence, fail to discover false entries on the books, and fictitious mortgages, running through many years, have been held liable for the money secretly withdrawn and covered thereby;[2] nor did the fact that managers of a savings bank had no time or ability to perform their duties, or that they had no knowledge of unlawful loans and investments, relieve them from such liability.[3] On the other hand, a court of general high authority has let itself down to the plane of holding that it is error to instruct a jury that "all directors of a corporation are presumed to know what it is their duty to know, what they are able to know, and what they undertook to know when they accepted the responsibility of directors; and a jury have a right to suppose that the directors of a corporation have a knowledge of its concerns. In the absence of direct and positive evidence of the knowledge of the directors, jurors have a right to assume that they are doing what they were appointed to do, and that they know what they are appointed to know."[4] It is merely putting the same proposition in another form of words, to say that knowledge of all the affairs of the bank, or of what its books and papers would show, cannot be imputed to a director for the purpose of charging him with a liability.[5] The true rule is exactly the

[1] Shea *v.* Mabry, 1 Lea (Tenn.), 319.

[2] Williams *v.* McKay, 46 N. J. Eq. 25; *s. c.* 18 Atl. Rep. 824.

[3] *Ibid.*

[4] Murray *v.* Nelson Lumber Co., 143 Mass. 250.

[5] Briggs *v.* Spaulding, 141 U. S. 132.

reverse. Another court applied the same indifferent conception to a case where a bank had been completely wrecked and gutted by its unfaithful servants, in the year 1884. The principal rascal was one Riddle, who officiated as its president. He proceeded, with the knowledge of the cashier and the co-operation of one or more clerks and subordinates. He literally emptied the vaults of the bank in carrying on a gigantic speculation in oil. Nevertheless, the Supreme Court of Pennsylvania held that the directors were not under an obligation to know this, and that they were not personally liable for not knowing it and preventing it.[1] The Supreme Court of Tennessee, in a case illustrating the same disposition to be lenient with a class of mandataries who assume the custody and proper care of the money of the general public, have held, in substance, that directors of a bank are not to be held liable for overdrafts by customers who are people of character and business integrity, though not having property from which payment could be coerced, where such overdrafts are not shown to have been authorized by the directors, nor are they shown to have had any actual knowledge thereof, though the facts of such overdrafts could have been ascertained from an examination of the entries upon the books of the bank.[2]

§ **4109. Liability for Negligent Acts Which are Ultra Vires.** The rule already adverted to,[3] which exonerates directors from responsibility for losses happening through mistakes of judgment and honest errors in exercising the discretionary power committed to them, applies in general only where they act within the scope of their powers. Where they assume to act outside the powers conferred upon the corporation, or outside the powers which the by-laws or other governing instruments have conferred upon them, then, for any losses happening in consequence of such action, their liability rests upon a higher ground than mere negligence: it rests upon

[1] Swentzel *v.* Penn Bank, 147 Pa. St. 140; *s. c.* 30 Am. St. Rep. 718; 23 Atl. Rep. 505.

[2] Wallace *v.* Lincoln Savings Bank, 89 Tenn. 630; *s. c.* 24 Am. St. Rep. 625.

[3] *Ante*, § 4103.

the ground of an *affirmative breach of trust.*[1] While, as stated hereafter, there may be in many cases ground for exonerating them in consequence of *mistakes of law*, yet where the governing statute or the by-laws have made the rule of their duty plain, and they step outside of that rule, and loss results, they are liable to make it good.[2] This theory, strictly carried out, would hold them to the liability of *insurers* whenever they should step outside the limits of their authority. It would also impose on them the obligation of knowing, in any given case, the extent of those limits, which often involves a nice question of law or interpretation, as to which judges might differ and courts reverse and contradict each other, and where the opinion of counsel could not furnish an absolutely safe guide. If we extend the principle by analogy, we shall see that it would render judges and ministerial officers, acting in good faith, personally liable for their *mistakes of law;* nor can any good reason which would shield judicial and ministerial officers from liability for such mistakes be suggested, which would not operate measureably to exonerate the directors and managing officers of corporations. The true theory therefore is, that the doctrine of a preceding section,[3] that directors and other managing officers of corporations are not liable for losses happening through *mistakes of judgment*, extends to *mistakes of law*, as well as to mistakes of fact.[4] If, therefore, the directors of a corporation, having acted in good faith and upon their best judgment for the interests of the corporation, do an act beyond the scope of their powers which has resulted in loss to the company,[5] — as if they have invested its funds in a manner not authorized by the charter, — they are not personally liable to the stock-

[1] Bargate *v.* Shortridge, 5 H. L. Cas. 297; *s. c.* 24 L. J. Ch. (N. S.) 457; *ante*, §§ 3999, 4019.

[2] Citizens' Loan Asso. *v.* Logan, 29 N. J. Eq. 110; Williams *v.* McKay, 40 N. J. Eq. 189; *s. c.* 53 Am. Rep. 775; Hun *v.* Cary, 82 N. Y. 65; *s. c.* 37 Am. Rep. 546; Brinkerhoff *v.* Bostwick, 88 N. Y. 52; Moses *v.* Ocoee Bank, 1 Lea (Tenn.), 398.

[3] *Ante*, § 4103.

[4] Hodges *v.* New England Screw Co., 3 R. I. 9; Thomp. Off. Corp. 259.

[5] Watts's Appeal, 78 Pa. St. 370.

holders therefor.[1] But, in seeming opposition to this, it has been held that an *erroneous belief* by the managers of a savings bank, not arising from misconstruction of the charter, as to the legality of certain unlawful investments and loans, does not relieve them from liability for resulting losses.[2] In line with this, it has been held that a director and member of the finance committee of a savings bank, who acts with the president in investing its funds in mortgages on land not worth twice the amount, contrary to a *prohibition* in the bank's charter, is chargeable with the loss on the investment, even though he did not act fraudulently, and derived no benefit from the loan, — the error not being a mere error of judgment or mistake in estimating the value of the property.[3] So the directors of a corporation incur a personal liability to it by voting for a resolution which they have no power, express or implied, to pass, authorizing the issue and negotiation of notes of the corporation, which are in effect void, where such notes are issued and come into the hands of *bona fide purchasers* for value.[4] Nor are directors relieved from personal liability for an *ultra vires* act plainly in breach of their trust, from the fact that they acted on the *advice* of able and experienced *counsel*, — as where the directors of an insurance corporation make an unlawful transfer of its assets to another company.[5] But where an *ultra vires* act was the act of *other directors or officers*, and the directors sought to be charged did not participate in it, and were not guilty of negligence within the doctrine of a preceding section,[6] they are not liable for the losses so occasioned.[7] If these decisions can be reconciled, it must be on some such idea as this: that

[1] Scott *v.* Depeyster, 1 Edw. Ch. (N. Y.) 513.

[2] Williams *v.* McKay, 46 N. J. Eq. 25; *s. c.* 18 Atl. Rep. 824; Dodd *v.* Wilkinson, 42 N. J. Eq. 647; *s. c.* 9 Atl. Rep. 685.

[3] Williams *v.* McDonald, 42 N. J. Eq. 392; reversing *s. c.* 37 N. J. Eq. 409.

[4] Metropolitan Elev. R. Co. *v.* Kneeland, 120 N. Y. 134; 8 L. R. A. 253; *s. c.* 30 N. Y. St. Rep. 782; 24 N. E. Rep. 381.

[5] Pierson *v.* Cronk, 26 Abb. N. Cas. (N. Y.) 25.

[6] *Ante*, § 4106.

[7] Movius *v.* Lee, 30 Fed. Rep. 298; *s. c.* affirmed, *sub nom.* Briggs *v.* Spaulding, 141 U. S. 132.

whether a director can be held liable for losses happening through an honest mistake as to his powers depends upon the question whether the mistake was a flagrant one — rising to the grade of that *crassa negligentia* which some of the courts require in order to charge a director for mistake and inattention in the discharge of his duties. The liability of a *subordinate officer*, as for instance the *treasurer*, rests upon a different ground. If the directors and stockholders concur in embarking the corporate funds in a business outside the limits of its articles or charter, a subordinate officer obviously ought not to be held liable for losses occurring through mere mistakes of judgment, where the act is otherwise within the sphere of his duties, merely for that reason. In such a case, the corporation would be *estopped*, upon the most obvious reasons, from thus taking advantage of its own wrong.[1]

§ 4110. Effect of Acquiescence on the Part of the Shareholders.—Although the shareholders in a corporation are not bound to look into the management, and will not be held to have *notice* of everything which has been done by the directors, who may be assumed by the shareholders to have done their duty,[2]—yet if they *do* know how the directors are managing its affairs, and that they are overstepping their granted powers, and if they stand by, and look on, and make no objection, they will be held to have acquiesced in the same, and will be precluded from holding the directors,[3] and more especially a subordinate ministerial officer,[4] to a personal liability; and under similar facts it has been held *that the State* cannot maintain a statutory action to *dissolve* the corporation.[5] The rule is of course stronger where the shareholders affirmatively

[1] Holmes *v.* Willard, 125 N. Y. 75; *s. c.* 11 L. R. A. 170; 34 N. Y. St. Rep. 455; 9 Rail. & Corp. L. J. 117; 25 N. E. Rep. 1083.

[2] Stanhope's case, L. R. 1 Ch. 161; *s. c.* 35 L. J. (N. S.) 296; 12 Jur. (N. S.) 79.

[3] Watts's Appeal, 78 Pa. St. 370; Henry *v.* Jackson, 37 Vt. 431. In such a case a *by-law* which the directors have overstepped is *waived:* Underhill *v.* Santa Barbara &c. Co., 93 Cal. 300; *s. c.* 28 Pac. Rep. 1049.

[4] Holmes *v.* Willard, 125 N. Y. 75.

[5] People *v.* Ballard, 3 N. Y. St. Rep. 845.

authorize the doing of the act which results in loss. Thus, it has been held that the directors of a corporation are not chargeable with any loss which the cessation of business and a liquidation of the affairs of the corporation, in furtherance of a vote of a majority of the stockholders, may entail upon the minority of stockholders.[1]

§ **4111. Liability of Directors for Each Other's Acts.** — If the obligation of directors to supervise the affairs of the corporation is of any substance, and is not a mere play upon words, it should seem that they are under an obligation to overlook each other's conduct in the management of the corporation, as well as the conduct of the subordinate officers and agents; and yet we have the very highest judicial authority for the conclusion that *directors of national banks* are not liable for the acts of their associates in which they had no part, and of which they had no knowledge. Thus, the directors of such a bank, which had become insolvent by reason of the losses caused by the discounting from time to time of paper not properly secured, but indorsed by a director who was a man of wealth and the largest stockholder in the bank, and in whom the other directors had reason to place confidence, were held not liable for the mere failure to discover the illegal transaction and to prevent the offending director from continuing therein.[2] So, it has been held that the directors of such a bank do not rest under a common-law liability for inattention to their official duties in not preventing a hazardous, imprudent, and disastrous loan, if the loan was made by their associates without their knowledge, connivance, or participation.[3] But on the question what *evidence* is admissible tending to show the participation of the directors sought to be charged with a breach of trust, it has been held competent

[1] Trisconi *v.* Winship, 43 La. An. 45; *s. c.* 9 Rail. & Corp. L. J. 469; 9 South. Rep. 29.

[2] Briggs *v.* Spaulding, 141 U. S. 132; affirming *s. c. sub nom.* Movius *v.* Lee, 30 Fed. Rep. 298; 24 Blatchf. (U. S.) 291.

[3] Witters *v.* Sowles, 31 Fed. Rep. 1; *s. c.* 24 Blatchf. (U. S.) 332. The writer submits that the foregoing decisions are unsound.

to prove that they participated for a series of years in *similar acts of misconduct*, although such previous acts are not in issue in the particular case. In other words, where the directors of a savings bank have, for a series of years, habitually pursued a course of misconduct in making loans in consequence of which the banks happen to suffer no loss, and finally *some* of the directors make a small illegal loan which does result in loss, the prior illegal course of conduct on the part of the other directors is an evidentiary fact tending to show that they authorized or participated in the making of the illegal loan for which it is sought to charge them.[1]

§ 4112. Liability of ex Officio Members for Each Other's Acts. — Let us suppose a case where the *president, secretary*, and *treasurer* of a corporation are *ex officio* members of the board of directors, and where the directors hold no meetings, but commit the entire management of the corporation to these three officers. Here it has been held that they do not stand liable for each other's acts on the theory of being compelled to watch over each other as *ex officio* directors, but that their liability is that of *officers*, — that is to say, each is severally liable for his own misconduct, in the absence of evidence of a joint participation in any particular act, which is not presumed, but must be proved.[2]

§ 4113. Application of These Principles to Banking Corporations. — Little need be said upon the question of the application of this chapter to the negligence of *bank directors* in the management of the trust funds committed to their charge, because a large proportion of the cases already dealt with were cases of that character. Bank directors do not, in strictness, occupy, in respect of their obligation of skill, care,

[1] Dodd *v.* Wilkinson, 42 N. J. Eq. 647; *s. c.* 9 Atl. Rep. 685. For a valuable collection of cases on the admissibility of *evidence of similar acts*, see 1 Thomp. Trials, § 329, *et seq.*

[2] North Hudson &c. Asso. *v.* Childs, 82 Wis. 460; *s. c.* 33 Am. St. Rep. 57; 52 N. W. Rep. 600. By analogy to the foregoing, it has been held that a report of the secretary is not competent *evidence*, in such a case, against the president and treasurer, to charge them with the losses. *Ibid.*

and diligence, any different position from that of directors of other corporations, if we except the possible case of *directors of savings banks.* The latter are, under many schemes of incorporation, *trustees for the depositors,* even while the institution is a going concern,—the object of the incorporation being to create an incorporated trustee to receive and invest the savings of the poor. In other banks the well-known rule of law is, that the relation of the bank to a depositor is merely that of debtor and creditor, and not that of bailor and bailee. It is only in theory of equity, or in virtue of statutes, that the directors become in any sense trustees for depositors while the institution continues solvent. But in a moral sense they are the custodians of the funds committed to their care by the stockholders and the depositors; and it is unquestionably the theory of courts of equity that this creates a relation of trust and confidence which demands on their part the degree of diligence and fidelity already spoken of; so that they become liable *to the corporation* or to its representative, and under statutes, and in some jurisdictions without the aid of statutes, *to its creditors,* for failing to exercise, in the discharge of their trust, ordinary care and diligence.[1] The liability of *directors of national banks* is unquestionably the same in substance, under the provisions of the National Banking Act, as under the principles of the common law and of equity.[2] It has been held in one of the Federal circuits, that if the right to forfeit the charter of a national bank for violations of law under the National Banking Act, is lost by lapse of time, the directors cannot be proceeded against individually for such violation;[3] but the decision seems to be a strange aberration, for there does not appear to be any connection between the two things except that they are spoken of in the same section of a statute.

§ 4114. Indictment of Directors for Negligent Failure to Perform Official Duties.—There is a valuable decision of the

[1] Delano *v.* Case, 121 Ill. 247; *s. c.* 2 Am. St. Rep. 81; 12 N. E. Rep. 676.

[2] Clews *v.* Bardon, 36 Fed. Rep. 617. The case of Briggs *v.* Spaulding, 141 U. S. 132, proceeds throughout on this assumption.

[3] Welles *v.* Graves, 41 Fed. Rep. 459; *s. c.* 7 Rail. & Corp. L. J. 392.

New York Court of Oyer and Terminer, under a statute forbidding railroad companies to heat their cars by means of the death-dealing stove, where several points of criminal law were ruled in reference to the indictment of directors for the failure to perform a duty enjoined by statute, where the neglect to perform the duty is made a misdemeanor,—the court holding that all active participants in violating such a statute are equally guilty, whether directors or other agents or servants, not officially but personally; and on the other hand, that mere neglect to comply with the statute,—here to change the mode of *heating the cars,*—will not make a director liable who has not personally participated in the commission of the offense; and finally, that a *foreign corporation cannot be indicted,* though its directors who participate in its unlawful acts can be.[1]

[1] People *v.* Clark, 14 N. Y. Supp. 642; *s. c.* 10 Rail. & Corp. L. J. 28.

CHAPTER LXXXI.

REMEDIES OF THE CORPORATION OR ITS REPRESENTATIVE AGAINST ITS UNFAITHFUL DIRECTORS.

SECTION
4118. General heads of liability to the company.
4119. Corporation may sue its directors either at law or in equity.
4120. Action whether legal or equitable.
4121. Right of action in receiver, and whether he can impeach corporate acts.
4122. Right of action in assignee for creditors.

SECTION
4123. Pendency of actions by creditors prevents subsequent actions by assignee.
4124. Directors when jointly liable.
4125. Pleading: declaration, bill, or complaint.
4126. Actions by assignees and trustees in bankruptcy.
4127. Certain defenses considered.
4128. Defense of the statute of limitations.

§ 4118. General Heads of Liability to the Company.— The general head to which the liability of directors to the company itself is referred, is that of *breach of trust.*[1] This breach may consist (1) of mere *non-feasance,* inattention, failure to perform duties which they have assumed towards the company,— that is to say, of negligence; or it may consist (2) of acts of *malfeasance,* fraud, or bad faith; or (3) it may consist of acts springing either out of negligence or bad faith, or blending these two elements together. But where the ground on which the rightfulness of the acts is impeached is that they are beyond the power of the directors — that is to say, *ultra vires,* these three grounds of liability blend together so closely that we shall not attempt in the following sections to preserve a distinct classification of them.

[1] *Ante,* § 4009, *et seq.* As to actions by *attorney-general* in New York, under Act of 1808, to recover misappropriated assets, see People *v.* Bruff, 60 How. Pr. (N. Y.) 1; People *v.* Ballard, 3 N. Y. St. Rep. 845. That an information by attorney-general *in equity* does not lie, see Attorney-General *v.* Utica Ins. Co., 2 Johns. Ch. (N. Y.) 371.

§ 4119. Corporation may Sue its Directors, either at Law or in Equity.— It is scarcely necessary to suggest that a suit for the purpose of setting aside transactions of the directors or their governing body, in fraud of the rights of the corporation, may be brought by the corporation itself. There is no possible doubt, either in England or in this country, of the right of a corporation to maintain such an action.[1] Indeed, actions at law are constantly maintained by corporations against their unfaithful directors, where the facts are appropriate for redress at law;[2] and in equity the question which most frequently arises is, not whether the corporation may bring such an action, but whether it is not the only party which can bring it.[3] Where the ground of action is *misfeasance* or *culpable negligence*, the *corporation*, not the *stockholders*, is a proper party plaintiff,[4] — though, under some remedial systems, the stockholders,[5] and often a creditor,[6] may maintain an *action at law;* and where the corporation is still under the control of the unfaithful directors, so that redress of the grievances cannot be had by an action in its name, a stockholder may maintain a proceeding in equity, suing for himself and all other stockholders, to protect the rights of the corporation, as trustee for its stockholders and creditors.[7] Actions brought by stockholders under this theory involve the rights of *minority stockholders*, as well as the rights of the corporation; and the questions arising in such actions are so numerous and complicated that it has been thought best to deal with them in a separate title.[8]

[1] Ryan *v.* Leavenworth &c. R. Co., 21 Kan. 365; Denny *v.* Manhattan Co., 2 Denio (N. Y.), 115; Cross *v.* Sackett, 16 How. Pr. (N. Y.) 62.

[2] Simons *v.* Vulcan Oil & Mining Co., 61 Pa. St. 202; *s. c.* 100 Am. Dec. 628; Branch Bank *v.* Collins, 7 Ala. 95; Franklin Fire Ins. Co. *v.* Jenkins, 3 Wend. (N. Y.) 130.

[3] *Post*, § 4471, *et seq.*

[4] Horn Silver Mining Co. *v.* Ryan, 42 Minn. 196; 44 N. W. Rep. 56; *post*, § 4472; Evans *v.* Brandon, 53 Tex. 56; Peabody *v.* Flint, 6 Allen (Mass.), 52; Smith *v.* Hurd, 12 Met. (Mass.) 371, 384; *s. c.* 46 Am. Dec. 690; Allen *v.* Curtis, 26 Conn. 456; Attorney-General *v.* Wilson, 1 Craig & P. 1.

[5] *Post*, § 4325.

[6] *Post*, §§ 4139, 4320.

[7] Craig *v.* Gregg, 83 Pa. St. 19, 21; Evans *v.* Brandon, 53 Tex. 56.

[8] *Post*, title VII.

§ **4120. Action whether Legal or Equitable.**—Where legal and equitable remedies are blended into one system under the modern codes, the *form of action* by the corporation against its directors, for misfeasance or culpable negligence, may be legal or equitable, according to the particular circumstances.[1] The proper remedy is said to be an action at law for damages, and not a bill in equity, where no accounting of the corporation's financial condition is necessary to determine the extent of their liability.[2] In Wisconsin, an action by a corporation against its *president* and *treasurer*, seeking to charge them as *ex officio* members of the board of directors, for having exceeded their power and usurped the powers of the board, without the knowledge, consent, or authority of the board or stockholders, has been treated as an equitable action, principally on the ground that the allegations of the complaint required different answers and different evidence to meet them, creating questions of procedure which can be best dealt with and overcome in an equitable action; but on the further ground (which does not seem tenable) that no recovery can be had at law against a minority of the board of directors for misconduct or negligence, inasmuch as they can act only when lawfully assembled, and their duties as such are devolved on them as a board, and not individually.[3] But there seems to be no doubt that whenever it can be shown that the directors of a corporation have been acting in violation of their trust; or have combined to injure the property of the corporation; or have fraudulently misappropriated the corporate funds for their own benefit or for the benefit of third persons; or have obtained undue advantage, benefit, or profit to themselves by purchase, sale, or other dealings with the same,—a court of equity has power to grant relief, and the rights of the corpo-

[1] Horn Silver Mining Co. *v.* Ryan, 42 Minn. 196; 44 N. W. Rep. 56.

[2] Thompson *v.* Greeley, 107 Mo. 577; 17 S. W. Rep. 962; Stephens *v.* Overstolz, 43 Fed. Rep. 771. Compare *post*, § 4309, *et seq.*

[3] North Hudson &c. Asso. *v.* Childs, 82 Wis. 460; *s. c.* 33 Am. St. Rep. 57; 52 N. W. Rep. 600. It was held error for the court below to treat it as an action at law, although both parties seem to have so understood it.

ration may be enforced by equitable remedies.[1] Indeed, the jurisdiction of courts of equity, to compel the unfaithful directors of corporations to account to the corporation for losses sustained by it through their frauds and breaches of trust, has been settled since the time of Lord Hardwicke.[2]

§ 4121. **Right of Action in Receiver, and whether He can Impeach Corporate Acts.** — The receiver of a corporation succeeds to the title of the corporation;[3] and whatever rights it might have asserted against its unfaithful directors, he may assert against them. A *receiver* of an insolvent national banking association, for instance, may enforce, for the benefit of stockholders, creditors, or depositors, any liability of its directors for non-performance or negligent performance of their duties.[4] Accordingly, he may maintain an action *at law* against a director to recover damages sustained by an *excessive loan*.[5] This is very clear; but whether the receiver of a corporation can go further and impeach corporate acts which are of such a nature that the corporation itself would be estopped to impeach them, has been questioned. In other words, it has been contended that his title is derivative,— that he can do nothing except what his assignor, the corporation, could have done. This, so far as our reading enables us to express an opinion, is not the general view of the courts. He occupies a higher plane than that of a mere representative of the company; he is also the representative of its creditors,[6]

[1] Ellsworth Woolen Man. Co. *v.* Faunce, 79 Me. 440, 445; *s. c.* 10 Atl. Rep. 250.

[2] *Ante*, § 4119; Charitable Corporation *v.* Sutton, 2 Atk. 400 (Anno. 1742); *s. c.* 9 Mod. 349; Thomp. Off. Corp. 226; Attorney-General *v.* Wilson, 1 Craig & P. 1, 2; *s. c.* 10 L. J. (Ch.) 53; 11 Jur. 1174; Bayless *v.* Orne, Freem. Ch. (Miss.) 161; Attorney-General *v.* Utica Ins. Co., 2 Johns. Ch. (N. Y.) 371; Citizens' Loan Asso. *v.* Lyon, 29 N. J. Eq. 110.

[3] High on Receivers, § 316; Curtis *v.* Leavitt, 15 N. Y. 9, 44; Brouwer *v.* Hill, 1 Sandf. (N. Y.) 629; White *v.* Haight, 16 N. Y. 310; Osgood *v.* Laytin, 48 Barb. (N. Y.) 464; *post*, ch. 161.

[4] Movius *v.* Lee, 30 Fed. Rep. 298; Howe *v.* Barney, 45 Fed. Rep. 668; *s. c.* 5 Bkg. L. J. 16.

[5] Stephens *v.* Overstolz, 43 Fed. Rep. 771; *s. c.* 4 Bkg. L. J. 52.

[6] "The better doctrine undoubtedly is, that he stands as the representative, both of the creditors of the

and, as such, he may assert against the corporation any right which they could have asserted. It is believed that he succeeds to rights of action as large as those of an assignee in bankruptcy, as stated in another section.[1] He may disaffirm certain acts of the corporation which are illegal and in violation of the rights of its creditors. He may maintain an action to set aside illegal transfers of securities belonging to the corporation.[2] He may maintain an action against the president of the corporation,[3] or against a director,[4] to recover corporate funds or securities which the latter has fraudulently abstracted.

§ 4122. Right of Action in Assignee for Creditors. — The *assignees* of an insolvent banking corporation may maintain an action against a director for damages for loss to the bank occasioned by the fraudulent sale to the bank of its own stock by a director. Such right of action being essentially one of property, as distinguished from a personal tort, passes by the assignment, and does not involve the setting aside of the conveyance as in fraud of creditors. The action may be brought by those representing the bank.[5]

§ 4123. Pendency of Actions by Creditors Prevents Subsequent Action by Assignee. — The pendency of bills in equity

corporation, and of its shareholders. He is not, therefore, the agent or representative of the corporation exclusively, but is to be regarded rather as trustee for both creditors and shareholders." High on Receivers, § 314; citing Gillet *v.* Moody, 3 N. Y. 479; Talmage *v.* Pell, 7 N. Y. 328, 347; Libby *v.* Rosekrans, 55 Barb. (N. Y.) 217.

[1] See also *post*, § 4326.

[2] Gillet *v.* Moody, 3 N. Y. 479.

[3] Butterworth *v.* O'Brien, 24 How. Pr. (N. Y.) 438.

[4] Gillet *v.* Phillips, 13 N. Y. 114; Hayes *v.* Kenyon, 7 R. I. 136. But *in Maine* the *trustees* appointed to wind up an insolvent corporation cannot sue for wrongs done by the officers *to the injury of creditors;* such an action must be brought by the creditors themselves. Piscataqua &c. Co. *v.* Hill, 60 Me. 178, 182. The general doctrine of the foregoing text has an analogy in the case of the *official liquidator* under the English Companies Acts, who can proceed against the directors for breaches of trust. See Re National Funds Assurance Co., 10 Ch. Div. 118; Feltom's Ex'rs case, L. R. 1 Eq. 219; Madrid Bank *v.* Bayley, L. R. 2 Q. B. 37; Re Cardiff Sav. Bank, 45 Ch. Div. 537; *ante*, § 4106.

[5] Shultz *v.* Christman, 6 Mo. App. 338; Grocers' National Bank *v.* Clark, 48 Barb. (N. Y.) 26.

by creditors (which must be consolidated) against directors of an insolvent corporation, proceeding on the ground of negligence and mismanagement, will prevent the assignee from maintaining a subsequent suit at law in the name of the corporation against the directors for the same cause. The reason is plain: the assignee, to say the least, has no better right to bring his action than creditors, and, as he is not prior in right, his action fails because it is subsequent in time. To hold that he is prior in right would in many cases defeat the purposes of justice, because the assignee is selected by the accused and delinquent directors themselves. He is, to a certain extent, their own hand, and they have presumptively selected that hand with the view that it shall not be turned against themselves.[1]

§ **4124. Directors when Jointly Liable.**—It has been held that in an action in equity by a receiver of a corporation against its directors to recover moneys fraudulently appropriated by them, a decree may be entered against them *jointly*.[2] So, under the modern codes, an action in the nature of an action *at law* may be maintained against directors of a corporation *jointly* and *severally*, for the amount of losses resulting from their suffering the corporate funds or property to be wasted or lost by gross negligence or inattention to their duties.[3] But it has been held that where the charter of a corporation fixes the number of directors at sixteen, and makes a majority of them necessary to constitute a board competent for the transaction of business, a *joint action at law* cannot be maintained against four for acts done as directors, for the reason that the four defendants are incapable of doing any corporate act, and cannot act jointly as directors. If they have wasted and lost the funds of the corporation, the action must be against them *severally*.[4]

[1] Warner *v.* Hopkins, 111 Pa. St. 328; *s. c.* 56 Am. Rep. 266.

[2] McCarty's Appeal, 110 Pa. St. 379.

[3] Horn Silver Mining Co. *v.* Ryan, 42 Minn. 196; *s. c.* 44 N. W. Rep. 56.

[4] Franklin Fire Ins. Co. *v.* Jenkins, 3 Wend. (N. Y.) 130.

§ 4125. Pleading: Declaration, Bill, or Complaint. — It has been held in New York, when the *common-law system of pleading* was in force, that a *declaration* containing a general charge that the defendants, as directors, lent the corporate funds on security known by them to be insufficient, without specifying time, person, or circumstances, is bad on demurrer; and so, if a declaration alleges the grievance to have been committed in part by want of care, and in part by corrupt and willful mismanagement.[1] A *bill* brought by the assignees of a foreign corporation against several citizens of Massachusetts, who had been its directors, alleging that they had not used the property and moneys of the corporation for lawful purposes, but had illegally misused and expended it, and divided some of the money among themselves for their own benefit, was held not demurrable.[2] If the action is grounded on negligence, it is not a *misjoinder of causes* of action to allege several distinct acts of negligence; nor need such a complaint negative *knowledge* or *acquiescence* on the part of the stockholders.[3]

§ 4126. Actions by Assignees and Trustees in Bankruptcy. An action against the directors of a corporation for losses happening to the corporation, in consequence of their gross negligence and habitual inattention to their duties, may be brought by *trustees in bankruptcy* of the corporation, and is properly brought in equity.[4] This was the title of an assignee in bankruptcy under the late bankrupt law; he might, as the representative of creditors, contest the validity of the acts of the bankrupt.[5] The assignee of a bankrupt corporation

[1] Franklin Fire Ins. Co. *v.* Jenkins, 3 Wend. (N. Y.) 130.

[2] Gindrat *v.* Dane, 4 Cliff. (U. S.) 260.

[3] Horn Silver Mining Co. *v.* Ryan, 42 Minn. 196; *s. c.* 44 N. W. Rep. 56. As to the effect of acquiescence, see *ante*, §§ 4025, 4076, *et seq.*

[4] Mutual Building Fund &c. Bank *v.* Bossieux, 4 Hughes (U. S.), 387.

[5] Clerk's Office *v.* Bank, 66 N. C. 214; *s. c.* 8 Am. Rep. 506; Re Metzger, 2 Nat. Bank. Reg. 355; Foster *v.* Hackley, 2 Nat. Bank. Reg. 406; *s. c.* 1 Ch. Leg. N. 137; Bradshaw *v.* Klein, 1 Nat. Bank. Reg. 542; *s. c.* 2 Biss. (U. S.) 20; McLean *v.* Buckingham, 3 McLean (U. S.), 185; *s. c.* 13 How. (U. S.) 151; Re Leland, 10 Blatchf. (U. S.) 503; Upton *v.* Hansbrough, 3

might impeach any transaction between the corporation and its creditors which its creditors might impeach. He might impeach a conventional payment of stock made by exchanging checks, with the view of changing the character of the transaction from a subscription of stock to an ordinary debt.[1] There were cases, however, where the assignee was not permitted to assert a higher right than his assignor had. Thus, where the corporation entered upon the business of discounting paper without authority of law, its assignee in bankruptcy could not, it was held, recover the money which it had so parted with. In respect of such a transaction, the assignee succeeded only to the title of the bankrupt corporation, and it had no title.[2] Neither could the assignee of a bankrupt corporation assert the rights of its creditors against its directors, under a statute making them liable for certain official defaults; for this liability was not in the nature of corporate assets.[3]

§ **4127. Certain Defenses Considered.** — *Delay* on the part of the *liquidator* of a corporation in bringing suit against the representatives of directors who have paid dividends out of capital, to recover the amounts so paid, has been held no defense to the suit, in the absence of prejudice thereby to the defendants.[4] To such action, for unliquidated damages arising solely from a *tort*, a defendant cannot set up a *discharge in bankruptcy*.[5] An action by a corporation against its promoters

Biss. (U. S.) 417; *s. c.* 10 Nat. Bank. Reg. 369; Re Jaycox, 7 Nat. Bank. Reg. 578; *s. c.* 13 Nat. Bank. Reg. 122; 12 Blatchf. (U. S.) 209; 13 Blatchf. (U. S.) 70; Sawyer *v.* Hoag, 17 Wall. (U. S.) 610.

1 Sawyer *v.* Hoag, 17 Wall. (U. S.) 610.

2 Re Jaycox, 13 Blatchf. (U. S.) 70.

3 Bristol *v.* Sanford, 12 Blatchf. (U. S.) 341. But see Gunkle's case, 48 Pa. St. 13; Piscataqua &c. Co. *v.* Hill, 60 Me. 178.

4 Masonic &c. Assur. Co. *v.* Sharpe, 10 Rail. & Corp. L. J. 292; *s. c.* affirmed [1892], 1 Ch. 154.

5 Hun *v.* Cary, 59 How. Pr. (N. Y.) 426, 439. It has been held that a corporation cannot recover upon a promissory note given to its manager, upon an allegation that it did business in the name of its manager, where the evidence showed that the note was given as a part of a personal transaction for the accommodation of the manager and without consideration, and where there was no evidence to show that the corporation

for fraudulently selling to the corporation a mining property, at a price greatly in excess of what they had represented as the cost of it to themselves, cannot be defeated on the ground that the money paid to the promoters for the property was obtained by the corporation as the proceeds of an unlawful issue of its shares, — they not being in a position to raise the question of the lawfulness of the organization, or the validity of the issue of its stock. The reason is, that they were active agents in the formation of the corporation, instrumental in the issue of the stock, and are consequently *estopped* by their own conduct.[1]

§ **4128. Defense of the Statute of Limitations.** — Where the corporation sues certain of its directors to recover the *secret profits* which they have made out of a corrupt agreement, the statute of limitations begins to run against the corporation or its representative, — *e. g.*, a receiver in charge of its assets after its insolvency, — only from the time when the corporation or the representative *acquires knowledge* of the corrupt agreement.[2] This is an application of the equity rule, which obtains under some of the codes of procedure, that in case of fraud the statute of limitations begins to run only from the *discovery of the fraud.*[3] Another court has held that, in an action by the receiver of an insolvent corporation,

had been defrauded or injured by the giving of it. Société des Mines D'Argent &c. *v.* Mackintosh, 7 Utah, 35; 24 Pac. Rep. 669.

[1] Pittsburg Min. Co. *v.* Spooner, 74 Wis. 307; *s. c.* 17 Am. St. Rep. 149; 42 N. W. Rep. 259; 5 Rail. & Corp. L. J. 566. Error to admit against the defendants without examination the report of an expert accountant called by the corporation. North Hudson Mut. Building &c. Asso. *v.* Childs, 82 Wis. 460; *s. c.* 33 Am. St. Rep. 57; 52 N. W. Rep. 600.

[2] Bent *v.* Priest, 86 Mo. 475, 487; affirming *s. c.* 10 Mo. App. 543, 562. The intermediate appellate court proceed on the ground that the case fell within the following clause of the statute of limitations: "Fifthly, an action for relief on the ground of fraud, the cause of action in such cases to be deemed not to have accrued until the discovery by the aggrieved party, at any time within ten years, of the facts constituting the fraud." Rev. Stats. Mo. 1879, § 3230; Bent *v.* Priest, 10 Mo. App. 543.

[3] Hunter *v.* Hunter, 50 Mo. 445, 452; and see Keeton *v.* Keeton, 20 Mo. 530, 541.

against its directors or managers, to recover for losses which the institution has sustained through their mismanagement, predicated upon illegal investments and overdrafts made by the president beyond the period of the statute of limitations, the statute may be set up as a defense; since the *trust* which exists in such a case[1] is not the species of *direct trust*, belonging exclusively to the jurisdiction of equity, which takes a case out of the statute of limitations.[2] At the same time, the rule is conceded that "in cases of *resulting*, *implied*, and *constructive* trusts, when a party is to be *constituted a trustee* by a decree of a court of equity founded on *fraud*, it is well settled as a rule of equity that the statute of limitations and presumption from lapse of time will operate."[3] But even here the statute does not begin to run until the time when the party complaining discovers the fraud.[4] On the contrary, the Supreme Court of Illinois have taken the position that the directors of a corporation are trustees of an *express trust*, within the principle that the statute of limitations does not run between a trustee and his *cestui que trust* in the case of express or direct trusts, so that the statute presents no bar to a suit in equity by a *receiver* of a corporation to hold its directors liable for misappropriations of its assets.[5] And this seems to be the correct view; for clearly the mass of decisions,[6] holding that directors are trustees in equity for the corporation and the shareholders, proceed upon no other conception than that they are trustees of an *express* or *direct trust*, — a trust expressed

[1] Williams *v.* Halliard, 38 N. J. Eq. 373.

[2] Spering's Appeal, 71 Pa. St. 11; *s. c.* 10 Am. Rep. 684; Thomp. Off. Corp. 233.

[3] Keeton *v.* Keeton, 20 Mo. 530, 541; following Spering's Appeal, *supra*.

[4] *Ibid.* Compare Chouteau *v.* Allen, 70 Mo. 290. To substantially the same effect is Wallace *v.* Lincoln Savings Bank, 89 Tenn. 630; *s. c.* 24 Am. St. Rep. 625; 9 Rail. & Corp. L. J. 482; 4 Bkg. L. J. 249; 15 S. W. Rep. 448.

[5] Ellis *v.* Ward, 137 Ill. 509; *s. c.* 25 N. E. Rep. 530; 33 Am. & Eng. Corp. Cas. 200.

[6] Pearson *v.* Concord Railroad Corp., 62 N. H. 537; *s. c.* 13 Am. St. Rep. 590; Sweeny *v.* Grape Sugar Co., 30 W. Va. 443; *s. c.* 8 Am. St. Rep. 88, 89, and note; Farmers' Bank *v.* Downey, 53 Cal. 466; *s. c.* 31 Am. Rep. 62; Simons *v.* Vulcan Oil &c. Co., 61 Pa. St. 202; *s. c.* Thomp. Off. Corp.

in the charters or governing statutes and in the by-laws or other governing instruments, prescribing the manner in which the directors shall conduct the business of the corporation.

172; 100 Am. Dec. 628; Hoffman &c. Co. *v.* Cumberland &c. Co., 16 Md. 456; *s. c.* 77 Am. Dec. 311; Philadelphia &c. R. Co. *v.* Cowell, 28 Pa. St. 329; *s. c.* 70 Am. Dec. 128; Bank *v.* Hill, 56 Me. 385; *s. c.* 96 Am. Dec. 470. Compare St. Louis &c. R. Co. *v.* Tiernan, 37 Kan. 606; and many others.

CHAPTER LXXXII.

LIABILITY OF DIRECTORS TO STRANGERS AND CREDITORS OF THE CORPORATION OUTSIDE OF STATUTE.

SECTION
4132. General nature of the liability of directors to persons not members of the company.
4133. Not liable as partners or original undertakers, except, etc.
4134. Personally liable where contract does not show that it was made for the company.
4135. Personally liable for acts in excess of their authority.
4136. Unless the question of the extent of authority is a mere question of law.
4137. Not liable to creditors for nonfeasance, negligence, mismanagement, breach of duty to corporation, etc.
4138. Bank directors not so liable to depositors.
4139. A limitation of this doctrine suggested, and contrary holdings stated.
4140. But liable to strangers for malfeasance.
4141. Such as fraudulent overissues of corporate stock.
4142. Or the fraudulent issuing of second mortgage bonds as "first mortgage bonds."
4143. Not liable for overdrafts.
4144. Issuing false prospectuses, making false representations, etc., whereby the public are deceived.
4145. Illustrations of this liability.
4146. Effect of statute of frauds.
4147. Doctrine that there must have been a guilty *scienter* or a fraudulent intent to deceive.
4148. Action by sureties against trustees for fraudulent statements.
4149. Remedies in equity.
4150. In what sense directors trustees for creditors.
4151. Liability for preferring creditors.
4152. Personally liable for fraudulently diverting the company's assets from its creditors.
4153. Illustrations of this liability.
4154. Liability to pay for "qualification shares."
4155. Creditor may also follow misappropriated assets as a trust fund.
4156. Corporation a party to suit in equity.
4157. Liability of a director for allotting shares to his own infant children.

§ 4132. General Nature of the Liability of Directors to Persons not Members of the Company.—The grounds on which the directors of corporations may make themselves liable *to strangers* have been already indicated.[1] They stand

[1] *Ante*, § 4091.

toward the outside and in the same relation in which any other agents stand toward the general public. For a breach of duty to their principal, redress can only be had by that principal, the corporation, or by the shareholders, if the corporation refuses to sue, as elsewhere pointed out.[1] But, for any breach of duty toward a stranger to the company, such stranger may have redress against them, either at law or in equity, according to the nature of the injury; and it will be no defense that their principal is also liable.[2] By a doctrine peculiar to the American courts, the capital stock of a corporation is deemed a *trust fund* for its creditors, and the directors of the corporation, or other custodians of this fund, are deemed trustees of all the beneficiaries of the fund, that is, of the creditors first, and afterwards of the shareholders. These heads of liability will be discussed in the succeeding sections.

§ 4133. Not Liable as Partners or Original Undertakers, except, etc. — Like other stockholders of the corporation, and like other agents and trustees, directors are not personally liable for the debts of the corporation, unless they make themselves so by frauds and breaches of trust as discussed in this chapter, or by violations of statutory duties as discussed hereafter.[3] In considering the question of their liability on any ground, we may start out with the *general principle* of their non-liability for the corporate debts and undertakings.[4] We have already had occasion to consider the principle that where a corporation exists *de facto*, its managers do not become personally liable for its debts from the mere fact that some *defect* or *irregularity* in the mode of organizing it under its charter or governing statute has taken place;[5] and we have had occasion to note the essential limitations of that principle, that where those essential *conditions precedent* have not supervened which entitle the coadventurers to make

[1] *Ante*, § 4091; *post*, § 4479.

[2] *Ante*, § 4096.

[3] *Post*, Ch. 83.

[4] Snyder *v.* Wiley, 59 Tex. 448.

[5] *Ante*, §§ 224, 2975; Bartholomew *v.* Bentley, 1 Ohio St. 37.

and take contracts as a corporation, the managers who assume to make contracts in its name are personally liable on those contracts.[1] Thus, as already seen,[2] persons acting as directors of an *inchoate corporation*, who contract debts in its name when less than the *minimum amount of capital* with which, under its constitution, it is entitled to commence business, has been subscribed,—become personally liable to make good those obligations, though acting in good faith.[3] Thus, where the *creditors* of a corporation selected three of their number to manage it as trustees in their interest, and these three were elected its directors, it was held that they could not be made *liable as partners* for supplies purchased by them in the name and behalf of the corporation and used in its business.[4] But even where the circumstances are such that the contracting directors make themselves personally liable, they do not in all cases make *other members*, or even *other officers*, personally liable by representation, as one partner binds his copartners; but whether they do so or not becomes very largely a *question of fact*, like the question of agency in other relations.[5] On the other hand, the facts may be such that while the contracting officer will not be personally liable, the trustees may be.[6] If the directors of an *inchoate corporation* enter upon the business for which the company is projected, and incur liabilities, and, for any reason, the company is *never incorporated*, such liabilities will be deemed their personal obligations, and they will be obliged to answer for them.[7]

§ 4134. Personally Liable where Contract does not Show that It was Made for the Company.—If the directors act as

[1] *Ante*, § 2969.

[2] Compare *ante*, §§ 246, 1235, 2969, 2983, 2989.

[3] Trust Co. *v.* Floyd, 47 Ohio St. 525; *s. c.* 21 Am. St. Rep. 846; 12 L. R. A. 346; 26 N. E. Rep. 110.

[4] Beeson *v.* Lang, 85 Pa. St. 197.

[5] *Ante*, § 423.

[6] Thus, the *president* of an incorporated *social club*, who was not also a trustee of the club, was held not liable, individually, for debts of the club, though incurred by him as president. Sieger *v.* Culyer, 2 Abb. N. Cas. (N. Y.) 347; affirmed 67 N. Y. 601. Liability of the *trustees of a church* to an innocent materialman. Tull *v.* Trustees, 75 N. C. 424.

[7] Doubleday *v.* Muskett, 4 Moore & P. 750; *s. c.* Thomp. Off. Corp. 291; *ante*, §§ 416, 2969.

contracting agents of the corporation, and sign contracts in that capacity, they will make themselves personally liable thereon, unless the contract distinctly, or by necessary implication, shows that it was made for the company, and not for themselves, and unless it sufficiently appears from the instrument that the obligee contracted upon the security of the corporate funds, and not on that of the personal responsibility of the directors.[1] Thus, where the managing director of a company entered into a covenant with a third person to pay a certain sum of money, in consideration of the assignment to him of certain concessions, such covenantee could not prove his claim against the company, although he may in fact have dealt with the covenantor as a trustee for the company.[2]

§ 4135. Personally Liable for Acts in Excess of their Authority.—The *general principle* with which this discussion was opened must be recurred to: it is, that an officer or contracting agent of a corporation, who enters into a contract in the name and on behalf of the corporation, is not personally bound thereon, *provided* the contract was *within the scope of his authority* as its contracting officer or agent; for in that case it is the act of the corporation.[3] But suppose that the contract is beyond the scope of his powers, so that it does not bind the corporation, then the inquiry arises, is it a void act in the sense that it binds no one? Must the obligee sustain the loss, while *some one* pockets the gains? The answer is that, by the common law of England, persons who induce others to act on the supposition that they have authority to enter into a binding contract on behalf of third persons, on its turning out that they have no such authority, may be sued for damages for a *breach of an implied warranty of authority.*[4] If, therefore, directors of a company which has no power to

[1] *Post*, § 5015, *et seq.*

[2] Pickering's Claim, L. R. 6 Ch. 525.

[3] Taylor *v.* Williams, 17 B. Mon. (Ky.) 489.

[4] Collen *v.* Wright, 7 El. & Bl. 301; *s. c.* 26 L. J. (Q. B.) 147; 8 El. & Bl. 647; 27 L. J. Q. B. 215; Cherry *v.* Colonial Bank of Australasia, L. R. 3 P. C. 24.

borrow money, nevertheless do borrow it and issue an obligation for the repayment of it, stating that it has been deposited with the company, and is not the obligation of the directors, they will be personally liable thereon, on the principle that they have committed a breach of warranty of authority. By signing the receipt, they in fact represent that they have authority to make a binding contract of loan on behalf of the company, and this representation being untrue, they are guilty of a breach of warranty of authority.[1] Upon the same grounds, where the directors of a company procure money to be advanced to the company after its borrowing powers have been exhausted, they will be personally liable to refund the same with interest.[2] But, in plain opposition to this principle, it has been held that if a bank, through its directors, issues notes in excess of the authority given by the law of its incorporation, the directors will not be personally liable to redeem the notes.[3] So, the fact that the directors have contracted an indebtedness in excess of the limit prescribed by its charter and the published notice of incorporation, does not render them liable to creditors of the corporation, unless made so by the provisions of the charter or some general statute; and it is immaterial that the creditors allege that credit was extended in reliance on the business character and responsibility of the directors.[4] But it has been held that an officer of a corporation who signs a subscription paper in the name of the corporation, but without having authority to do so, and without giving information of his want of authority, is personally liable to contribute to others signing and incurring expense on the faith of his subscription.[5]

§ 4136. Unless the Question of the Extent of Authority is a Mere Question of Law.— Under this head the courts take a

[1] Richardson *v.* Williamson, L. R. 6 Q. B. 276.

[2] Weeks *v.* Propert, L. R. 8 C. P. 427.

[3] Sandford *v.* McArthur, 18 B. Mon. (Ky.) 411.

[4] Frost Man. Co. *v.* Foster, 76 Iowa, 535; *s. c.* 41 N. W. Rep. 212.

[5] Solomon *v.* Penoyar, 89 Mich. 11; *s. c.* 50 N. W. Rep. 644.

distinction between a breach of warranty of agency which involves a misapprehension of fact, and such a breach which involves a misapprehension as to matter of law. It has been justly considered that where the question whether the directors have authority to bind the company in the thing proposed, is a question of law merely, and they represent, directly or impliedly, that they have such authority, and it turns out that they have not, this will not make them liable personally; because it would be a startling proposition that if you ask a man's opinion on a question of law, and he answers you wrongly, and you act upon his opinion and thereby sustain injury, you have an action against him for damages.[1] In seeming conformity with this principle, it has been held that the directors of a corporation do not, in the absence of a statute so providing, render themselves personally liable for making, on behalf of the corporation, contracts which it has no power to make, or which it is prohibited from making. Thus, if a corporation, through its directors, *purchases its own shares* and afterwards avoids the purchases, the directors do not become personally liable to the vendor.[2]

§ 4137. Not Liable to Creditors for Non-feasance, Negligence, Mismanagement, Breach of Duty to Corporation, etc. Recurring to a principle already stated,[3] we find that it has been held that the fact that directors and officers of a corporation have *mismanaged* its business does not render them liable to creditors, unless they are made liable by the provisions of the articles of incorporation or by statute.[4] The proposition is that "a wrong to the corporation which may and does affect the credit of the company and the creditors generally, is not a wrong to them as individuals, and they cannot maintain an action [against the directors] as for a

[1] Rashdall *v.* Ford, L. R. 2 Eq. 750; *s. c.* 35 L. J. (Ch.) 769; 14 Week. Rep. 950; 14 L. T. (N. S.) 790. See the judgment of Lord Justice Mellish in Beattie *v.* Ebury, L. R. 7 Ch. 777, 798; *ante*, § 2945.

[2] Abeles *v.* Cochran, 22 Kan. 405; *s. c.* 31 Am. Rep. 194.

[3] *Ante*, § 4091.

[4] Frost Man. Co. *v.* Foster, 76 Iowa, 535; *s. c.* 41 N. W. Rep. 212.

tort."[1] Therefore, in the absence of statute, the holder of the bills of a bank cannot maintain an action against the directors, on the ground that their misconduct has rendered such bills worthless.[2] So, a bill by a creditor of a *national bank*, which, after setting out the indebtedness of the bank to the plaintiff, states that the defendant directors "did not give that care, supervision, and attention to the affairs of the bank which the duties of their office and the nature of the trust reposed in them required; but, on the contrary, neglected the same, and intrusted the entire business concerns of the bank to [its president and cashier], who recklessly and improvidently loaned the money and securities of the bank to various embarrassed and insolvent firms and individuals, without taking proper and sufficient securities for the protection of the creditors and others confiding in the directors' management of the bank, and recklessly converted the money of the bank to their use; the said president and cashier carrying a joint account at said bank, which at the time of its failure was overdrawn in the enormous sum of over sixty thousand dollars,"— exhibits no right of action against the directors; since their personal liability can only be enforced by the proceedings prescribed by sections 5234 and 5239 of the Revised Statutes of the United States.[3]

§ 4138. Bank Directors not so Liable to Depositors.— Neither, in the absence of a special statute,[4] are the directors of a bank liable to a general depositor for *mismanaging* the affairs of the bank so that his debt is lost; for unless they are made liable by statute, the breach of duty of which they have been guilty, is to the bank and not to its customers.[5] But it is conceded that directors of a bank may make themselves liable to ordinary depositors in damages, for false and *fraudulent representations* made by them, whereby the depositors have suffered

[1] Priest *v.* White, 89 Mo. 609, 617; Winter *v.* Baker, 34 How. Pr. (N. Y.) 183; *s. c.* 50 Barb. (N. Y.) 432.

[2] Branch *v.* Roberts, 50 Barb. (N. Y.) 435.

[3] National Exchange Bank *v.* Peters, 44 Fed. Rep. 13; *s. c.* 4 Bkg. L. J. 48.

[4] Numerous statutes exist giving such rights of actions, as elsewhere shown. *Post*, § 4240, *et seq.*

[5] Zinn *v.* Mendel, 9 W. Va. 580.

loss; and perhaps also for acts done by them with intent to deceive and defraud the public generally, which have had that effect, and which have caused loss to such depositors.[1] In this respect, an attempt has been made by one court to draw a distinction between the directors of a corporation and its mere agents and ministerial officers. The former, this court say, are not mere agents, like cashiers, tellers, and clerks. They are regarded as trustees for the stockholders, and, in a qualified sense, are the corporation itself. Their contract, continues this court, is not alone with the corporation. They invite the public to deal with it, and when any one accepts their invitation, he has the right to expect reasonable diligence and good faith at their hands. Accordingly, the directors of a bank were held liable for the acts of the ministerial officers of the corporation for converting special deposits of money and paying them out to the general creditors of the bank.[2] We have noticed this case elsewhere, and merely remark, in passing, that it is not generally regarded as sound law. Although there may be difficulty in many cases in determining whether the wrong complained of was a wrong towards the corporation or a wrong towards the plaintiffs, yet this case does not lie so near the border line as to have created difficulty. Unless we fail to understand the cases, directors of corporations are not under such a liability as this case puts upon them, except where it has been placed upon them by statute.[3]

§ 4139. A Limitation of This Doctrine Suggested, and Contrary Holdings Stated.—It is submitted, however, that creditors may be affected by wrongs done to the corporation

[1] Zinn *v.* Mendel, 9 W. Va. 595, *per* Haymond, P.; Maisch *v.* Saving Fund, 5 Phila. (Pa.) 30; Leffman *v.* Flanigan, 5 Phila. (Pa.) 155.

[2] United Society of Shakers *v.* Underwood, 9 Bush (Ky.), 609; *s. c.* 15 Am. Rep. 731; 13 Am. Law Reg. (N. S.) 211.

[3] See Judge Redfield's criticism on this case in 13 Am. Law Reg. (N. S.) 218, and the doubt expressed by Haymond, P., in Zinn *v.* Mendel, 9 W. Va. 580. As to the difference between general and special deposits, see Planters' Bank *v.* Union Bank, 16 Wall. (U. S.) 483; Marine Bank *v.* Fulton Bank, 2 Wall. (U. S.) 252.

by the directors, in such a manner as to have an action against the latter for damages. Suppose, for instance, that a corporation is held out to the world by its directors as possessing a certain capital stock and as being solvent and worthy of credit. Suppose that those directors proceed secretly to honeycomb the corporation, — to convert the assets to their own use until it becomes a mere shell. Suppose that in this state of facts, outside persons, acting upon the faith of what the directors hold out to the world, give credit to the corporation and it afterwards fails, leaving their debts unpaid. Can it be said that the persons thus deceived and cheated have no action against the persons who have thus deceived and cheated them? The question answers itself.[1] One court, proceeding in this direction, has passed the bounds of principle, by making the directors of an insolvent bank liable for the *conversion* of certain *special deposits* of the plaintiff which had taken place in consequence of their *negligence*, without the aid of a statute.[2] A decision of the Court of Appeals of Virginia, in like manner, holds the directors of a *savings bank* liable to *depositors* for gross negligence and inattention, whereby the assets have been wasted;[3] though it should be observed that the directors of a savings bank or savings fund sustain a much closer trust relation to depositors than do the directors of an ordinary commercial bank; and besides, notwithstanding the fact that a complacent court placed its decision on the ground of *negligence*, the institution was honeycombed with *fraud*.

§ **4140. But Liable to Strangers for Malfeasance.** — It is a well-settled principle, as we shall see when we come to consider the subject of *torts* of corporations,[4] that the fact of being the officer or agent of a private corporation confers no immu-

[1] See *post*, §§ 4144, 4152.

[2] United Society of Shakers *v.* Underwood, 9 Bush (Ky.), 609; *s. c.* 15 Am. Rep. 731.

[3] Marshall *v.* Farmers' &c. Bank, 85 Va. 676; *s. c.* 17 Am. St. Rep. 84; 8 S. E. Rep. 586. Compare Bank *v.* Boisseaux, 4 Hughes (U. S.), 398; *s. c.* 3 Fed. Rep. 817; Litchfield *v.* White, 3 Sandf. (N. Y.) 545.

[4] *Post*, § 6288. See also *ante*, § 4091.

nity from responsibility for *trespasses* and other acts of *malfeasance* committed towards *strangers* to the corporation. In such cases both the *principal* and the *agent*, the *corporation* and the *officer*, may be liable; and the fact that the corporation is liable does not exonerate the officer. Thus, where *collaterals* are pledged to a bank to secure an indebtedness, it is not lawful for the bank to re-pledge them without authority from its pledgor, much less to *sell* them; and it has been held that when the cashier of a bank, under such circumstances, sells such collaterals, and is sued for their conversion, he cannot defend on the ground that he acted *officially*.[1] So where an agent of a bank, without authority from the bank or its charter, pays away, for his bank, its money to an officer of another bank, who knows of such want of authority, the officer is personally liable for the money, although he has paid it over to his principal, the bank of which he was an officer.[2] So, the officers and agents of a corporation, by whose direction and assistance it *infringes a patented invention* of a third person, are personally liable for the infringement in like manner with the corporation;[3] though there is one case holding that the liability is that of the corporation alone.[4] Difficulties will no doubt arise in particular cases in determining whether the officer through which the corporation acts to the injury of a third person is liable to such third person as a trespasser, or whether the corporation alone is liable. The following case, illustrative of this difficulty, may be cited. The board of directors of a railroad company authorized their chairman to make a certain contract. Pursuant to that authority he made and signed, in behalf of the corporation, a contract with a manufacturer for the construction of a number of cars, to be

[1] Hempfling *v.* Burr, 59 Mich. 294.

[2] American Bank *v.* Wheelock, 45 N. Y. Super. Ct. 205.

[3] Iowa Barb Steel Wire Co. *v.* Southern Barbed Wire Co., 30 Fed. Rep. 123; Cahoone Barnet Man. Co. *v.* Rubber &c. Harness Co., 45 Fed. Rep. 582; National Car-brake Shoe Co. *v.* Terre Haute Man. Co., 19 Fed. Rep. 514; Goodyear *v.* Phelps, 3 Blatchf. (U. S.) 91; Poppenhusen *v.* Faulke, 4 Blatchf. (U. S.) 495. Conceded in Lightner *v.* Brooks, 2 Cliff. (U. S.) 287; and in Lightner *v.* Kimball, 1 Lowell (U. S.), 211.

[4] United Nickel Co. *v.* Worthington, 13 Fed. Rep. 392.

delivered to the railroad company. The cars were to be furnished with a certain patent improvement, which the manufacturer had no license to use. In a suit by the patentee against the chairman for an *infringement of the patent,* it was held that the contract of the chairman could not be construed as authorizing or contemplating any trespass upon the rights of the patentee, and that he was not liable. The fact that the cars were run on the road after completion gave no right of action against the chairman, as his authority extended only to the making of the contract.[1] In like manner, since it is now established that a corporation may become liable civilly for damages for the publication of a *libel,*[2] the *directors* of a corporation which publishes a newspaper will not be held liable personally for the publication of a libel in their paper, except upon evidence making it appear that they personally aided or advised its publication, or that their official duties were of such a character as to charge them with knowledge of it prior to the fact.[3]

§ 4141. Such as Fraudulent Overissues of Corporate Stock.—In conformity with this principle, if the officers of a corporation issue its stock in excess of the limit allowed by its charter, and make other fraudulent issues of its stock, so that the purchaser of such shares cannot be admitted to the rights of a stockholder, they are liable to the *purchaser* of such shares, and to other shareholders, under principles already gone over.[4]

§ 4142. Or the Fraudulent Issuing of Second Mortgage Bonds as "First Mortgage Bonds."—If the directors of a corporation issue a series of corporate bonds, and cause to be printed across the face of them the words "First Mortgage Bonds," and there is in fact a prior mortgage upon the property to secure an indebtedness, the directors will be liable for

[1] Lightner *v.* Brooks, 2 Cliff. (U. S.) 287.

[2] Missouri &c. Ry. Co. *v.* Richmond, 73 Texas, 568, 572; *s. c.* 15 Am. St. Rep. 794; *post,* ch. 138.

[3] Belo *v.* Fuller, 84 Tex. 450; *s. c.* 31 Am. St. Rep. 75; 19 S. W. Rep. 616.

[4] *Ante,* § 1503.

damages in an action for deceit to any one who, on the faith of such statement, bought the bonds on the market.[1] In such a case the mere fact that the title of the property is of record in the office of the public registry of titles is no defense to the action. It is not a good argument that, because an examination of the records would have disclosed the true state of the property, as respects this prior incumbrance, the plaintiff had no right to rely upon these alleged representations.[2] But it has been held that an *implied covenant against incumbrances*, in a mortgage executed by the president and secretary of a corporation, is not a fraudulent representation that will preclude one of the directors, who did not sign the mortgage, from claiming the benefit of a prior mortgage held by him.[3]

§ **4143. Not Liable for Overdrafts.**—There is reason for the conclusion that the directors of a corporation who signed checks for it in the manner in which its checks, drawn upon its banker, are usually signed, do not make themselves personally liable for an overdraft, in case the company becomes insolvent and unable to meet its obligations.[4] The reason is, that it is not understood by either party, the directors or the banker, that the directors, in drawing the drafts, are pledging their personal credit, or doing anything more than pledging the credit of the corporation. When, therefore, a company is organized, and has a balance at its bankers, the mere fact that three of its directors write an order to the bankers requesting them to honor checks of the company signed by two of its directors, and countersigned by its secretary, will not make the directors signing this request personally liable for any overdrafts which may be made in pursuance of it.[5]

[1] Clark *v.* Edgar, 12 Mo. App. 345; *s. c.* affirmed, 84 Mo. 106; 54 Am. Rep. 84.

[2] *Ibid.*, 84 Mo., at p. 111, opinion by Black, J.

[3] Mullanphy Bank *v.* Schott, 135 Ill. 655; *s. c.* 25 Am. St. Rep. 401; 26 N. E. Rep. 640.

[4] Beattie *v.* Lord Ebury, L. R. 7 H. L. 102; modifying *s. c.* L. R. 7 Ch. 777; and reversing *s. c.* L. R. 7 Ch. 788, n.; 20 Week. Rep. 994; 30 L. T. (N. S.) 581; 22 Week. Rep. 897.

[5] Beattie *v.* Lord Ebury, *supra.*

§ 4144. Issuing False Prospectuses, Making False Representations, etc., whereby the Public are Deceived.—This subject has already been considered, in so far as it concerns the issuing by the directors or promoters of a company of false prospectuses or statements with regard to its condition, whereby the public are deceived into *purchasing its shares.*[1] Acts of this kind fall within the category of acts of *malfeasance*, for which the directors participating therein are personally liable, notwithstanding the fact that the corporation may also be liable on a principle already stated.[2] Promoters, directors, or officers of corporations, setting forth such statements, are bound not only to abstain from stating as facts that which is not true, but to omit no fact within their knowledge the existence of which might affect the advantages held out as inducements.[3] They are personally liable to a stockholder for a loss of money which they induce him to loan to the corporation by false representations made fraudulently, or in ignorance of matters which it was their official duty to know.[4] On the one hand, a party contracting with a corporation, who was at the time in a position where, by ordinary business vigilance, he could readily have known the exact

[1] *Ante*, § 1460, *et. seq.*

[2] *Ante*, § 4096. The principle will be found illustrated in the cases cited in the following sections. There is a learned note on the subject in 8 Am. St. Rep. 604. A recent illustration of the doctrine may be found in Arnison *v.* Smith, 41 Ch. Div. 348. Other cases in illustration of the doctrine are: Hubbard *v.* Weare, 79 Iowa, 678; *s. c.* 44 N. W. Rep. 915; Kinkler *v.* Junica, 84 Tex. 116; *s. c.* 19 S. W. Rep. 359. See, *contra*, Mabey *v.* Adams, 3 Bosw. (N. Y.) 346. See Bolz *v.* Ridder, 12 Daly (N. Y.), 329. That the publication by savings bank directors, that directors and stockholders are personally responsible for its debts, does not constitute a contract with depositors, but if intentionally false, affords the basis of an action for deceit,—see Westervelt *v.* Demarest, 46 N. J. L. 37; *s. c.* 50 Am. Rep. 400. That equity will confer relief in such cases has already been shown: *Ante*, § 1483; Stainback *v.* Fernley, 9 Sim. 556. That a broker who, relying upon the false statements of a company as to the genuineness of one of its stock certificates, guarantees it on a sale, and pays over the proceeds to his principal, can *recover from the company* the amount paid by him in making good his guaranty of said certificate of stock,—see Jarvis *v.* Manhattan Beach Co., 53 Hun (N. Y.), 362; *s. c.* 25 N. Y. St. Rep. 1; 6 N. Y. Supp. 703.

[3] *Ante*, § 1477; Hubbard *v.* Weare, 79 Iowa, 678; *s. c.* 44 N. W. Rep. 915.

[4] Kinkler *v.* Junica, 84 Tex. 116; *s. c.* 19 S. W. Rep. 359.

condition of the affairs of the corporation, he being at the time a director, and having access to its books, will not be relieved on the grounds of fraudulent representations by the officers of the corporation;[1] yet on the other hand, the originator and promoter of an enterprise, who is also the business manager, and fully conversant with every fact of its past history and present condition, and who, by false representations as to the value of the stock of the company, induces a stranger to the enterprise to trade valuable property for stock upon which the former places an exorbitant valuation,—is not relieved from liability for damages because the purchaser of the stock did not make diligent inquiry as to the truth or falsity of the representations.[2] It was no defense to an action to charge the directors of a corporation for false representations, whereby the plaintiff was induced to lend money to the corporation, that under the by-laws they had *no power* to make the loan; since by accepting the loan they estopped themselves from denying their power to make it.[3] Upon the question what will be a *waiver* of a right of action grounded on such fraudulent representations, it has been held that one who has been thereby induced to purchase stock in a corporation, does not waive his right to sue for damages, by the fact that he afterwards, and before suit, offered the stock for sale at the price paid by him, or because four or five months elapsed between the sale and the institution of his suit.[4] But, of course, the party deceived may waive any right of action which he may have for damages founded on the deceit, by a subsequent agreement, the legal effect of which is to liquidate the damages in case the representation does not become true.[5]

§ **4145. Illustrations of This Liability.**—Thus, it has been held that *bank directors*, who permit the bank to be held out as

[1] Powell *v.* Adams, 98 Mo. 598; *s. c.* 12 S. W. Rep. 295.

[2] Cottrill *v.* Crum, 100 Mo. 397; *s. c.* 18 Am. St. Rep. 549; 13 S. W. Rep. 753.

[3] Kinkler *v.* Junica, 84 Tex. 116.

[4] Cottrill *v.* Crum, 100 Mo. 397; *s. c.* 18 Am. St. Rep. 549; 13 S. W. Rep. 753.

[5] Werner *v.* Pen Argyl Land Imp. Co., 133 Pa. St. 457; *s. c.* 19 Atl. Rep. 417.

solvent, when they know it to be insolvent, may be sued by a *depositor* for the damages which he has thereby sustained.[1] So, the directors of an insurance company who fraudulently permit false statements to be officially made and published by the president and secretary as to its assets and condition, whereby a person is induced to insure in the company, are liable in damages to him in case he suffers a loss covered by his policy, and his claim therefor proves worthless in consequence of the insolvency of the company.[2] So, where the capital stock of a company is not paid up, but the directors represent that it is fully paid up, in consequence of which representation a party *purchases a note* of the company, the directors are liable in damages in an action for deceit; but they will not be liable *ex contractu*, because the contract is not their contract, but that of the corporation. Therefore, they cannot be joined as defendants in an action *upon the note* to recover of the makers and indorsers.[3] So, where the *president* of a railway company sold coupons from its mortgage bonds, with a warranty that they were unpaid, when in fact they were paid, he was liable in damages, and to the amount paid him for the coupons, there being no evidence of their market value.[4] So, if a number of adventurers form a corporation, elect themselves officers, and proceed to business without subscribing the minimum amount required by the statute, as a condition precedent to its commencing business, they make themselves liable to creditors to the extent of this minimum amount, with interest,[5] and in the opinion of most courts they are liable generally as *partners*.[6] And they will not be entitled, as against creditors, to retain any sums drawn from the corporate assets under the name of "salaries," it not appearing that the company made any profits out of which to pay salaries.[7] So, if *one* of the promoters of a corporation, for the purpose of inducing a stranger to subscribe for its shares, conceals material facts which he ought to disclose,[8] whereby such stranger is induced to *purchase such shares* to his damage, *all* of the promoters who are jointly interested in the venture will be per-

[1] Delano *v.* Case, 121 Ill. 247; *s. c.* 2 Am. St. Rep. 81, Sheldon and Craig, JJ., dissenting.

[2] Salmon *v.* Richardson, 30 Conn. 360; *s. c.* 79 Am. Dec. 255.

[3] National Bank *v.* Texas Investment Co., 74 Tex. 421; *s. c.* 12 S. W. Rep. 101.

[4] South Covington &c. R. Co. *v.* Gest, 34 Fed. Rep. 628.

[5] Burns *v.* Beck, 83 Ga. 471; *s. c.* 10 S. E. Rep. 121.

[6] *Ante*, §§ 246, 2983, 2989.

[7] Burns *v.* Beck, *supra.*

[8] *Ante*, § 450; Hubbard *v.* Weare, 79 Iowa, 678; *s. c.* 44 N. W. Rep. 915.

sonally liable in damages.[1] So, where the president of a corporation, for the purpose of inducing a person, whom we will call A. B., to take stock in the company, makes false representations concerning the company to C. B., intending that such representations shall be communicated to A. B., and they are so communicated to the agent of A. B., who, relying upon them, purchases the stock for A. B., to his damage, — A. B. will have an action against the president for the damages so sustained.[2] In another case, an incorporated *savings bank* published an advertisement in a newspaper which contained the following representation: "Directors and stockholder personally responsible." A person saw this advertisement, and, because of it, became a depositor in the bank. Upon his pass-book, given him by the bank, there was the following printed statement: "The directors and stockholders are personally responsible for all debts and engagements of the bank." The bank having afterwards become insolvent, he brought an action against the directors to recover the amount of his deposit in the bank at the time of its suspension, alleging that the defendants agreed, in consideration of the deposit being made in the bank, that they would be personally responsible therefor, and pay the same on demand. It was held: 1. That the alleged agreement was an agreement to answer for the debt or default of another, and was hence within the *statute of frauds*, and not valid *as a contract*, because there was no note or memorandum thereof in writing *signed* by the defendants. 2. That while the representations possessed none of the essential features of a contract, they *might afford ground of an action for damages for deceit*.[3]

§ **4146. Effect of Statute of Frauds.** — A clause of the *statute of frauds*, as enacted in most of the States, provides that no action "shall be brought to charge any person upon, or by reason of, any representation or assurance made concerning the character, conduct, credit, ability, trade, or dealings of any other person, unless such representation or assurance be made *in writing*, and signed by the party to be charged thereby, or by those persons by him thereto lawfully author-

[1] Brewster *v.* Hatch, 122 N. Y. 349; *s. c.* 19 Am. St. Rep. 498; 33 N. Y. St. Rep. 527; 9 Rail. & Corp. L. J. 5; 25 N. E. Rep. 505. See *ante*, § 4094.

[2] Hubbard *v.* Weare, 79 Iowa, 678; *s. c.* 44 N. W. Rep. 915.

[3] Westervelt *v.* Demarest, 46 N. J. L. 37; *s. c.* 50 Am. Rep. 400.

ized."[1] The construction of this clause of the statute of frauds is that it is applicable only to cases where the intent and purpose of the party making the representation is to enable a third person to obtain credit, goods, or money by means of it.[2] In Massachusetts it is held that the fact that the party making the representation has a personal interest in procuring the credit to be given, does not take the case out of the statute, but that he is not liable in case the representation turns out to be false, unless it is in writing. It was so held where the defendant, by reason of false representations as to the credit and ability of another, induced the plaintiff to indorse a note signed by that other, which note the defendant received and used for his own benefit.[3] Neither could an action be maintained against an agent of an insurance company for oral misrepresentations concerning its pecuniary condition and credit, although made in order to enable him to receive a commission out of the premium given for the insurance thereby procured.[4] Neither did an action lie to charge a person by reason of false oral representations concerning the credit and ability of a corporation of which he was *treasurer*, made in order to induce the plaintiff to receive a note of the corporation signed by him as treasurer.[5] The same construction of the statute shielded the *directors* of a corporation from

[1] Rev. Stats. Mass., ch. 74, § 3; Pub. Stats. Mass., ch. 78, § 4. Similarly, see How. Stat. Mich., § 6188; Rev. Stats. Mo., § 2515; drawn from 9 Geo. 4, ch. 14, § 6. This statute is regarded as a part of the statute of frauds, but has not been adopted in all American jurisdictions. In construing it, it is held that if written representions are the substantial inducements, a recovery can be had, although some reliance may have been placed upon oral assurances. Tatton *v.* Wade, 18 C. B. 371; Clark *v.* Edgar, 84 Mo. 106, 111; *s. c.* 54 Am. Rep. 84. That is to say, if the oral representations are merely *incidental*, or stated in furtherance of the main ground of the complaint, they will not bring the case within the statute. *Ibid.* See, construing the statute, Devaux *v.* Steinkeller, 3 Jur. 1053, and other cases below cited.

[2] Kimball *v.* Comstock, 14 Gray (Mass.), 508; Medbury *v.* Watson, 6 Met. (Mass.) 246; *s. c.* 39 Am. Dec. 726; Norton *v.* Huxley, 13 Gray (Mass.), 285.

[3] Mann *v.* Blanchard, 2 Allen (Mass.), 386.

[4] Wells *v.* Prince, 15 Gray (Mass.), 562.

[5] McKinney *v.* Whiting, 8 Allen (Mass.), 207.

personal responsibility for an oral misrepresentation concerning its condition, whereby the corporation procured credit.[1] The statute, as thus construed, is justly styled a *statute of frauds*, because it is a statute tending not to suppress, but to produce and encourage frauds, and as such is disgraceful to an enlightened system of jurisprudence. The Supreme Court of Michigan, on the contrary, hold that such a statute has no application to conspiracies or frauds, where the representation is made to enable the party making it to profit by it.[2] Nor did it have any application to a case where the fraudulent representations were made as to an alleged *corporation* which had *no legal existence*, and where the pretense of the legal existence of the corporation was itself a fraud,—because in such a case the representation was not a representation as to the character or credit of another person.[3] It was obviously no defense to an action to charge directors with a personal liability to one who had purchased *second mortgage bonds* of the corporation, fraudulently stamped by them as *first mortgage* bonds.[4]

§ 4147. Doctrine that there must have been a Guilty Scienter or a Fraudulent Intent to Deceive.—Where the action is at common law for damages inflicted upon the plaintiff by reason of the deceit, it proceeds upon a lower plane than a suit in equity for a rescission of the contract on the same ground.[5] In the former case it is necessary, by the principles of the common law, for the plaintiff to aver and prove what is called a *scienter*, that is to say, a *fraudulent intent to deceive*, and he cannot recover upon the basis of a misrepresentation put forth through mere *carelessness* or *inattention*.[6] This is not necessarily incompatible with the prin-

[1] Hunnewell *v.* Duxbury, 157 Mass. 1; *s. c.* 31 N. E. Rep. 700.

[2] Hess *v.* Culver, 77 Mich. 598; *s. c.* 18 Am. St. Rep. 421; 43 N. W. Rep. 994; 6 L. R. A. 498.

[3] *Ibid.*

[4] Clark *v.* Edgar, 84 Mo. 106, 111; *s. c.* 54 Am. Rep. 84.

[5] *Ante*, § 1463.

[6] Derry *v.* Peek, 14 App. Cas. 337; reversing *s. c.* 37 Ch. Div. 541; Pasley *v.* Freeman, 3 T. R. 51; and Hay-

ciple upon which courts of equity have proceeded in these cases, that the promoters, directors, or officers of corporations, putting forth false statements concerning their condition, are as much bound to refrain from stating as true *what they do not know to be true*, as from stating as true what they know to be false, since in both cases there is a guilty *scienter*.[1] Proceeding upon the principle that in order to support an action for damages at common law grounded upon deceit, there must have been a fraudulent intent to deceive,— something in the nature of moral delinquency, — it has been held in New Jersey in an able and learned decision by Depue, J., after reviewing many authorities, that where a depositor in a savings bank sues a director for deceit in representing that the bank was solvent, there can be no recovery unless there was a fraudulent purpose to deceive, and that this is a *question of fact;* and further, that the rule is not varied by the circumstance that the defendant was a member of the finance committee, and, as such, must have known the financial condition of the bank.[2]

§ 4148. Action by Sureties against Trustees for Fraudulent Statements. — Sureties, who have been induced to sign the bond of a *bank treasurer* by oral statements as to the soundness of the bank, made by trustees of the bank as

craft *v.* Creasy, 2 East, 92; Cowley *v.* Smyth, 46 N. J. L. 380; *s. c.* 50 Am. Rep. 432; Hubbard *v.* Weare, 79 Iowa, 678; *s. c.* 44 N. W. Rep. 715; Weir *v.* Bell, 3 Ex. Div. 238; *s. c.* 31 Moak. Eng. Rep. 235. Compare Taylor *v.* Ashton, 11 Mees. & W. 401. In consequence of the decision in Derry *v.* Peek, *supra*, the rule was fixed in England by a statute known as the "Directors' Liability Act," 53 & 54 Vict., ch. 64.

[1] See, for instance, Hubbard *v.* Weare, 79 Iowa, 678; *s. c.* 44 N. W. Rep. 915, — where both of these propositions were asserted. This case was regarded as a case in equity, but the court took the just and sensible view that whether tried at law or in equity, the same rule as to *scienter* must apply; "for clearly we cannot have two different rules of law in the same State, for the same case, in the same court." It should have been added, where substantially the same relief is demanded. In the particular case the plaintiff demanded relief against the defendant personally for misrepresentations made by him when president of a corporation, touching its condition, whereby the plaintiff suffered loss.

[2] Cowley *v.* Smyth, 46 N. J. L. 380; *s. c.* 50 Am. Rep. 432.

individuals, to third persons, not intended to get to the knowledge of the sureties or to induce them to sign, — cannot maintain an action against such trustees for damages which they have sustained in so becoming sureties, predicated on the fact of such representations being false and fraudulent.[1]

§ **4149. Remedies in Equity.** — The power of a court of equity to deal with the subject, where the defrauded party proceeds for a rescission, is not so circumscribed as is the power of courts of law. The former courts do not deal so much with the *motive* as with the *fact and result.* This may be illustrated by a leading case where a company was formed for mining purposes. The prospectus referred to the memorandum and articles of association, and described in favorable terms a mine, for the purchase of which a contract had been entered into. This mine was afterwards found to be worthless, and the directors rescinded the contract, and agreed to purchase another. It was held that a shareholder who had subscribed on the faith of the prospectus was entitled to an injunction against an action for calls, although the directors had themselves been deceived and had been guilty of no willful fraud; the reason being that directors are bound to ascertain the truth of the representations made on their prospectus.[2] On the other hand, a director, who finds himself liable to become involved in actions for damages by reason of such fraudulent prospectuses, may have an injunction to restrain the unauthorized use of his name in connection therewith.[3]

§ **4150. In What Sense Directors Trustees for Creditors.** — It is a part of the doctrine already considered that the *capital*

[1] Ashullot Savings Bank *v.* Albee, 63 N. H. 152; *s. c.* 56 Am. Rep. 501; denying Graves *v.* Lebanon Nat. Bank, 10 Bush (Ky.), 23; *s. c.* 19 Am. Rep. 50.

[2] Smith *v.* Reese River Co., 2 L. R. Eq. Cas. 264.

[3] Routh *v.* Webster, 10 Beav. 561; *s. c.* 11 Jur. 701. That the creditors are not obliged to go into equity, but may proceed at law, see State Bank *v.* Andrews, 18 N. Y. St. Rep. 167.

stock of a corporation is a trust fund for its creditors,[1] that the directors of the corporation, who are the managers of that fund, are *trustees*, in respect of it, for such creditors. In some cases, it has been said that the directors are trustees for the creditors of the corporation,[2] because it is proper that they should be protected against fraudulent acts on the part of the directors, by which they might be deprived of collecting their debts in the usual way against the corporation.[3] But statements of this kind are made quite guardedly. Thus, the directors are said to be trustees of the creditors "to a considerable degree,"[4] or "in a certain sense."[5] It is also said, speaking of bank directors, that they are not trustees in a technical sense, but that their relation to the corporation is rather that of an agent to his principal, when viewed with reference to the rights of creditors.[6] The author has not found any English case which formulates the American "trust fund" doctrine, but in one case in that country it was distinctly denied.[7] This doctrine was first distinctly announced in this country by Mr. Justice Story in a case at circuit in 1824.[8] He professed to found it on the doctrine of an early English chancery case;[9] but that case affords no adequate

[1] *Ante*, § 2951, *et seq.*

[2] Jackson *v.* Ludeling, 21 Wall. (U. S.) 616; Cunningham *v.* Pell, 5 Paige (N. Y.), 607; Richards *v.* New Hampshire Ins. Co., 43 N. H. 263; Bliss *v.* Matteson, 45 N. Y. 22; Conro *v.* Port Henry Iron Co., 12 Barb. (N. Y.) 27. That the president of a gravel-road company borrowing money on duly authorized assessments against abutting lands, who collects the assessments on the faith of which the loans were obtained, holds the funds as a trustee for the lenders, and is personally responsible to them for any diversion thereof,—see Pugh *v.* Miller, 126 Ind. 189; *s. c.* 25 N. E. Rep. 1040.

[3] Cunningham *v.* Pell, *supra.*

[4] Jackson *v.* Ludeling, 21 Wall. (U. S.) 616, 624.

[5] Bliss *v.* Matteson, 45 N. Y. 22, 26.

[6] Briggs *v.* Spaulding, 141 U. S. 132; *s. c.* 10 Rail. & Corp. L. J. 62; 5 Bkg. L. J. 41. See *ante*, §§ 3968, 4009.

[7] Poole's case, 9 Ch. Div. 322, 328. The American doctrine appears to have been adopted from the English doctrine that the property of a *charitable* corporation is a trust fund, and that the court of chancery has jurisdiction over its custodians as trustees. See Green's Brice's Ultra Vires (2d ed.), 50, and the American note; also Attorney-General *v.* Aspinwall, 2 Myl. & C. 613.

[8] Wood *v.* Dummer, 3 Mason (U. S.), 308.

[9] Curson *v.* African Company, 1 Vern. Ch. 121.

basis for the doctrine. It really goes no further than to hold that a court of equity will help a creditor to collect his debt out of the assets of a corporation which is his debtor, just as it will out of the assets of a natural person when the creditor has no adequate remedy at law. The "trust fund" doctrine is rather to be regarded as a mere judicial invention, proceeding from the fertile brain of Mr. Justice Story, and taken up and followed by all American courts out of deference to the authority of that eminent judge and law writer. A disposition is shown in some recent American cases to limit the doctrine to the case of *insolvent corporations;*[1] and it has even been said that the directors of an insolvent corporation are not trustees of its funds for its creditors in any different sense from that in which any insolvent debtor is such a trustee for his creditors,[2]— a position which is believed to be untenable. But in the case of corporations formed for business purposes, including ordinary commercial banks, the difficulty of holding the directors to a liability growing out of the dual and contradictory positions of *agents for the corporation* and *fiduciaries of its creditors* is very great. They are not even the agents of its stockholders in the sense that the latter may sue them at law for damages growing out of the manner in which they have performed or failed to perform the duties of such a supposed agency.[3] And the general view is that, in the absence of statutes making a different rule, they are not liable to the creditors of the corporation on the theory of being their fiduciaries.[4] To these statements exceptions are no doubt admitted in the case of *savings banks, savings funds*, and *mutual insurance companies*, where the depositors or members are, under the statutory schemes governing these corporations, in a sense the beneficiaries of a trust, with the execution of which the directors are charged.

[1] *Ante*, § 2953.

[2] *Ibid.*

[3] Smith *v.* Hurd, 12 Met. (Mass.) 371; *s. c.* 46 Am. Dec. 690; Thomp. Off. Corp. 249.

[4] Smith *v.* Poor, 40 Me. 415; *s. c.* 63 Am. Dec. 672; Zinn *v.* Mendel, 9 W. Va. 580; Winter *v.* Baker, 34 How. Pr. (N. Y.) 183; Fusz *v.* Spaunhorst, 67 Mo. 256, 264.

§ 4151. Liability for Preferring Creditors. — Whatever view upon this subject may obtain in respect of the *status* of directors of solvent corporations, yet if a shadow of the American doctrine remains that the assets of a corporation are a trust fund for its creditors, the conclusion must be that, as soon as the line of insolvency is reached or sensibly approached, the directors do assume the relation of trustees in equity for the creditors of the company. The duty then devolves upon them, as such trustees, of holding the funds of the corporation for a ratable distribution among its creditors, according to the principles of equity, preserving the liens and priorities of those who are entitled to liens and priorities. In pursuance of this theory, as we shall see, the great weight of judicial authority is that the directors of an insolvent corporation, or of a corporation approaching insolvency, *cannot prefer themselves as its creditors* over other general creditors.[1] Upon the same ground it has been held that if in the distribution of this trust fund, the corporation being insolvent so that there is not enough for all, the directors prefer some of the creditors and leave others to go unpaid, they must answer to the latter out of their personal estates. The reason is simple: they are trustees for *all* the creditors; and in the administration of their trust, they must treat equally the beneficiaries in the trust; failing in this, they must answer personally, to those injured.[2] But this rule must not be carried so far as to make directors responsible to the holder of a litigated claim, which, after being established, goes unpaid, when, acting in good faith, but without proper care, they reserve a sum which they think will be sufficient to meet all claims, this included, and it turns out to be insufficient.[3] In England, where the doctrine that the directors of a company are trustees for its creditors does not obtain, the rule is different; the directors do not make themselves liable by preferring particular creditors, although it is done to absolve themselves from liability as guarantors.[4] Where the officers,

[1] *Post*, ch. 146.

[2] Richards *v.* New Hampshire Ins. Co., 43 N. H. 263.

[3] Lyman *v.* Bonney, 118 Mass. 222.

[4] Poole's case, 9 Ch. Div. 322, 328.

and shareholders of a corporation prefer themselves as creditors, they are not, according to a low conception, estopped, as against unsecured creditors, from denying that the corporation had a capital of $25,000, by the fact that its manager used letter-heads stating the capital to be $25,000, in the absence of proof that the creditors became such on the faith of such representation.[1]

§ **4152. Personally Liable for Fraudulently Diverting the Company's Assets from its Creditors.**—Directors of corporation, are under an extensive liability to the creditors of the corporation by force of *statutes* which exist in nearly all the States. This liability, so far as it has been the subject of adjudication in the courts, will form the subject of the next chapter. We shall in this section consider a class of American decisions in which directors of corporations have been held *answerable out of their private estates* for fraudulently diverting the assets of the company from its creditors and appropriating them to their own use. We here again meet with the doctrine already often alluded to,[2] that the capital stock of a corporation is a trust fund, primarily for the benefit of its creditors, and secondarily for its shareholders. Perhaps this rule is nothing more than an extension of a principle which is applicable to the assets of every deceased or insolvent debtor. In giving relief to the creditors of corporations on this ground, the courts of equity proceed on the familiar principle that whoever is found in possession of a trust fund, under circumstances which charge him with a knowledge of the trust, is bound to account as trustee to those beneficially interested in such fund.[3] The shareholders of a corporation are conclusively charged with notice of the trust character which attaches to its capital stock. As to it they cannot

[1] Warfield *v.* Marshall County Canning Co., 72 Iowa, 666; *s. c.* 2 Am. St. Rep. 263; 34 N. W. Rep. 467.

[2] *Ante*, §§ 1569, 2951.

[3] Adair *v.* Shaw, 1 Sch. & Lef. 243, 262; Hill *v.* Simpson, 7 Ves. 152; Wood *v.* Dummer, 3 Mason (U. S.), 308, 312; Bank of St. Mary's *v.* St. John, 25 Ala. 566, 620; Calhoun *v.* King, 5 Ala. 523; Gratz *v.* Redd, 4 B. Mon. (Ky.) 178.

occupy the *status* of innocent purchasers, but they are, to all intents and purposes, privies to the trust. When, therefore, they have in their hands any of this trust fund, they hold it *cum onere* — subject to all the equities which attach to it.[1] If this is true of shareholders, it is true for stronger reasons of directors, who, under all schemes of corporate organization, must not only be shareholders, but who also, as the managing agents of the corporation, are, in a certain sense, the custodians of the fund itself.[2] But every such case must be allowed to stand upon its own merits, and no hard-and-fast rule can be applied. Where a director makes *bona fide* advances of money to the corporation, as he may lawfully do,[3] the mere fact that he appropriates to his own use accounts due to it, after it has become insolvent, to pay interest accruing on such advances, has been held, in the absence of fraud, not ground of charging him with liability to creditors.[4] Nor are the directors of a corporation which is insolvent, but still doing business, personally liable to creditors by reason of making a *bona fide* sale of the assets of the corporation to an attaching creditor, upon his agreement to cancel his own debt and discharge the debts of other attaching creditors, — especially where the transfer is advised by counsel, and no means are at the disposal of the directors with which to contest the attachment suits.[5]

§ 4153. Illustrations of This Liability. — Let us look for applications of this doctrine. The managing director of a bank *withdraws its funds* to a very large amount, *without security*, and uses them in his private business, in consequence of which the bank becomes insolvent. This is such a fraud upon the creditors of the bank as renders the directors liable to account in equity for the

[1] Wood *v.* Dummer, 3 Mason (U. S.), 313; Adler *v.* Milwaukee Patent Brick Co., 13 Wis. 57, 62; Gratz *v.* Redd, 4 B. Mon. (Ky.) 178, 196.

[2] Gratz *v.* Redd, *supra.*

[3] *Ante*, § 4068.

[4] Kraft-Holmes Grocery Co. *v.* Crow, 36 Mo. App. 288.

[5] White &c. Man. Co. *v.* Pettes Importing Co., 30 Fed. Rep. 864.

amount so withdrawn.[1] So, if the directors *declare dividends* when there are in reality no surplus assets, a judgment creditor of the corporation may maintain a bill in equity against a director who, as a shareholder, has received such dividends, to subject them to the payment of his debt; and this is so, although the dividend declared was not in cash, but in the shape of a credit on his stock subscription.[2] On like grounds, where the charter of a bank required its *stock to be paid in gold and silver* and in notes or bills which the corporators or directors might deem equivalent to or better than specie, and the directors had taken in payment of stock subscriptions, notes which the subscribers had indorsed for each other, it was held by a very able lawyer sitting as special judge, that this would make the directors personally liable to the note-holders and creditors for the whole amount of the capital paid up in this manner. The directors accepting such securities instead of coin would each be liable for the whole amount so accepted in breach of their faith to the public. Others coming in after them would be liable on the same ground; while those that suffered the securities thus existing, however inferior to that of coin to which the creditors were entitled for their security, to be lost by the statute of limitations, would, for a stronger reason, be subject to the same liability. Such trustees would be subject to the same measure of liability for securities lost by their negligence, particularly if, as in this case, they had been in possession of such assets for years, and were admonished by suit of the creditors to whom they had refused

[1] Bank of St. Mary's *v.* St. John, 25 Ala. 566. This case contains *dicta* which we apprehend are not good law. It is laid down by Ligon, J., although the question was not involved in the case, that the directors of a bank are trustees for its creditors in such a sense that if they appropriate to their own use the trust assets, a court of equity will, at the suit of creditors, make them liable not only for the fund itself, but for all profits they may have made by its use. *Ibid.* 620. It is thought that the true rule is that as to creditors of the corporation, the directors are not in such a fiduciary relation as will make them liable to account to the creditors for the secret profits which they may have made in dealing with the trust fund; though, as already seen, they occupy such a relation to the corporation itself, and to the shareholders. *Ante,* § 4024. See Lexington &c. R. Co. *v.* Bridges, 7 B. Mon. (Ky.) 556; *s. c.* 46 Am. Dec. 528.

[2] Gratz *v.* Redd, 4 B. Mon. (Ky.) 178, 191, 196; recognized in Lexington &c. R. Co. *v.* Bridges, 7 B. Mon. (Ky.) 566; *s. c.* 46 Am. Dec. 528. Compare Osgood *v.* Laytin, 5 Abb. Pr. (N. S.) (N. Y.) 1; Rorke *v.* Thomas, 56 N. Y. 559.

information, to diligence and good faith.[1] Although the decision of the case was put upon other grounds, there seems no doubt of the general soundness of these observations. It has been distinctly ruled by another court, that if the charter of a bank require a certain portion of the *capital stock* to be *paid in in specie*, before the directors are permitted to issue any bank notes, and the directors, in disregard of this inhibition, put in circulation notes of the bank, and the bank afterwards becomes insolvent, the billholders and creditors may proceed at once against the stockholders for the subscribed stock not paid in, and against the directors for the breach of trust which they have thus committed.[2] For the same reason, the directors of a *saving fund* are liable to account in equity to the depositors for the maladministration of their trust.[3] A bill by the depositors of such an institution, which alleges that the directors and officers violated the provisions of its charter as to the character of their investments; that they were grossly negligent in leaving the business of making investments in the hands of two or three officers; that often unsafe and improper investments were made which resulted in the entire loss of the money of the complainants; that false estimates were put upon property held by the society, so as to swell the amount of the assets and give the institution an appearance of soundness, while at the same time false representations were held out to the public through advertisements and notices in the newspapers as to the mode in which the business was conducted, and the nature of the security on which loans were made, — was a

[1] Moses *v.* Ocoee Bank, 1 Lea (Tenn.), 398, opinion of Heiskell, special judge, affirming decree of Cooper, chancellor. As to the payment of stock subscriptions, see *ante*, § 1562, *et seq.*

[2] Schley *v.* Dixon, 24 Ga. 273; *s. c.* 71 Am. Dec. 121. There is a case among the decisions of the Supreme Court of New York (Branch *v.* Roberts, 50 Barb. (N. Y.) 436), where it is ruled that the holders of bills of a bank cannot maintain an action against directors on the ground that such bills have been rendered valueless by the misconduct of the directors; Clerke, J., saying that a stockholder cannot sue directors for damages on the ground that his stock has been made valueless by the misconduct of the directors, and if a stockholder cannot do it, a creditor cannot. This case is not in harmony with the current of American doctrine on this subject, and is not good law. Besides, the court is not one of last resort, and its decisions are not, in the accepted sense, authority.

[3] Maisch *v.* Saving Fund, 5 Phila. (Pa.) 30. The jurisdiction of equity to call the directors of a saving fund to account is also very ably maintained by Hare, J., in Leffman *v.* Flanigan, 5 Phila. (Pa.) 155.

good bill.[1] So, it has been held that where one corporation holds the property of an insolvent corporation in trust for administration among its creditors, and the directors of the trustee corporation misapply such assets, they make themselves personally liable to the creditors of the insolvent corporation, although the trustee corporation had assumed the debts of the insolvent corporation.[2] But it has been held that it is not necessarily a fraud on the creditors of a corporation for its trustees to purchase property from one of their number, for the alleged benefit of the corporation, paying therefor the entire capital stock of the corporation. Such a transaction may or may not be fraudulent, according to circumstances.[3]

§ 4154. Liability to Pay for "Qualification Shares."—The next inquiry is, whether in case the charter or other governing instrument requires that each director shall hold a certain number of shares in the corporation, one who becomes a director is *ipso facto* liable to pay for that number of shares, in order to satisfy the demands of creditors in the event of the insolvency of the corporation. This question does not seem to have arisen in this country, though there are a great many decisions upon it in the English courts. As the author has reviewed these decisions in a previous work at some length,[4] and has referred to the more important of them in a previous title of this work,[5] he will do no more at present than to state what seems to be the general conclusions to be deduced from a mass of more or less conflicting cases. These conclusions are: 1. That the mere fact of accepting the office of director does not make the person a shareholder in respect of the number of shares necessary to qualify him to hold the office, but that it merely implies an agreement that he will qualify himself by procuring, either from the company or from some shareholder, the necessary shares.[6] 2. But that where he

[1] Maisch *v.* Saving Fund, *supra.*

[2] National Bank *v.* Texas Investment Co., 74 Tex. 421; *s. c.* 6 Rail. & Corp. L. J. 373; 12 S. W. Rep. 101.

[3] Knowles *v.* Duffy, 40 Hun (N. Y.), 485.

[4] Thomp. Off. Corp., p. 368, *et seq.*

[5] *Ante,* §§ 1260, 1261.

[6] *Ante,* § 1260; Forbes's case, L. R. 8 Ch. 768; Brown's case, L. R. 9 Ch. 102. *Contra,* Re Disderi, L. R. 11 Eq. 242. Compare Hay's case, L. R. 10 Ch. 593, 604; *s. c.* 44 L. J. (Ch.) 721; 33 L. T. (N. S.) 406; Re Englefield

accepts the office of director and acts as such, and suffers himself to be held out as a shareholder, either by having his name put on the register as such, or otherwise, then he is deemed to have accepted the necessary number of shares to qualify him, and will not be allowed to repudiate them after the company becomes insolvent.[1] 3. A director who actually accepts the shares necessary to qualify him will not be allowed to repudiate them on account of any informality in the transaction.[2] 4. That this rule of liability does not apply to the provisional directors who are permitted to hold shares supplied to them and paid for by the promoter or his agent,[3] which is not permitted in the case of directors required to be qualified as such by holding a stated number of shares.[4] 5.

Colliery Co., 8 Ch. Div. 388; Saunder's case, L. R. 20 Eq. 506; Chapman's case, L. R. 2 Eq. 567; Austin's case, L. R. 2 Eq. 435; Jenner's case, 7 Ch. Div. 132; Hamley's case, 5 Ch. Div. 705; Barber's case, 5 Ch. Div. 963. Contrary to the rule declared in later cases, persons who had acted as directors, and who had even permitted their names to appear in the prospectus as such, for the purpose of raising further capital, were permitted to show that they did not qualify in certain particulars; *e. g.*, that they did not apply for shares (Green's case, L. R. 18 Eq. 428); that, although shares were allotted to them, they never signed the subscription contract (Maitland's case, 3 Giff. 28); that they were informed that no qualification shares were necessary; and that they never executed or saw the deed of settlement: Re Clark, 14 C. B. (N. S.) 676.

[1] Fowler's case, L. R. 14 Eq. 316; Leeke's case, L. R. 6 Ch. 469; Harward's case, L. R. 13 Eq. 30; Carling's case, L. R. 20 Eq. 580; Stephenson's case, 45 L. J. (Ch.) 488. Compare De Ruvigne's case, 5 Ch. Div. 306; Miller's case, 3 Ch. Div. 661; *s. c.* affirmed, 5 Ch. Div. 70; Sidney's case, L. R. 15 Eq. 228 (signed memorandum of association, attended meeting of directors, and then resigned, and yet was held liable). The rule was held not to apply where the qualification was fixed by a resolution, and not in the articles of association: De Ruvigne's case, 5 Ch. Div. 306.

[2] Walter's case, 3 De Gex & Sm. 149; affirmed on appeal, 19 L. J. (Ch.) 501; Roney's case, 4 De Gex, J. & S. 426. And such would seem to be the rule where a person has agreed to become an officer of the company, *e. g.*, a local manager, and has applied for the requisite number of shares to qualify him for the position, and in some respects entered upon the duties of his office. Richards *v.* Home Asso., L. R. 6 C. P. 591.

[3] Forbes's case, L. R. 8 Ch. 768.

[4] Re Disderi, L. R. 11 Eq. 242. See the following *cases, where the directors were exonerated* except for those shares for which they had actually subscribed: Tothill's case, L. R. 1 Ch. 85; Hamilton's case, L. R. 8 Ch. 548. Compare Currie's case, 3 De Gex, J. & S. 367; *s. c.* 32 L. J. (Ch.) 424; and Stock's case, 4 De Gex, J & S. 426.

That a person who has consented to act as director is entitled to resign the office without prejudice, if he does so within a reasonable time, and before actually having assumed the duties of the position, in which case he will not be held to a liability to pay for qualification shares for which he has not subscribed.[1]

§ **4155. Creditor may also Follow Misappropriated Assets as a Trust Fund.** — If the directors of a corporation misappropriate its assets and divert them into their own hands and the hands of their stockholders, its creditors may follow them there, and, with the aid of a court of equity, charge them with the payment of their debts and impound them and subject them for that purpose.[2] So, where a *partnership* firm is *incorporated*, its creditors may follow its assets into the hands of the officers of the corporation.[3] But of course this doctrine has no application to the case of a fair purchase by a director of property of the corporation at a judicial sale.[4] At least, such a purchase passes the *legal title;* and therefore the purchaser at a subsequent sale on execution issued on a judgment against the corporation, cannot maintain a *writ of entry* against him and his grantees, some of whom were also directors.[5] And, of course, here as elsewhere in respect of the *following of*

Circumstances under which directors cannot hold such shares as a gift from the promoters: Ex parte Daniell, 1 De Gex & J. 372; Carling's case, 1 Ch. Div. 115; Pearson's case, 4 Ch. Div. 222, and 5 Ch. Div. 336; Re Disderi, L. R. 11 Eq. 242. Compare Currie's case, 3 De Gex, J. & S. 367. Circumstances under which directors may hold unpaid qualification shares as paid up: Miller's case, 3 Ch. Div. 661; Currie's case, 3 De Gex, J. & S. 367. Compare De Ruvigne's case, 5 Ch. Div. 306.

[1] Karuth's case, L. R. 20 Eq. 506. See also Barber's case, 5 Ch. Div. 963. Abercorn's case, 4 De Gex, F. & J. 78.

[2] Union Bank *v.* Douglass, 1 McCrary (U. S.), 86.

[3] Where a corporation, organized by the members of a partnership, passes a resolution to purchase the assets of the partnership, and assumes its indebtedness, it cannot, by a secret understanding between the trustees that certain claims are not included, prevent the creditor from following the firm's assets into the hands of the corporation. Williams *v.* Colby, 6 N. Y. Supp. 459.

[4] As to such purchases, see *ante*, § 4071.

[5] Saltmarsh *v.* Spaulding, 147 Mass. 224; *s. c.* 17 N. E. Rep. 316; 4 Rail. & Corp. L. J. 151.

trust funds with the aid of equity, the doctrine has no application where the fund has lost its identity, or has passed into the hands of a *bona fide purchaser without notice;* in either case the remedy of the creditor is lost.[1] The unpaid stock of a corporation being a trust fund for its creditors,[2] it cannot be disposed of by the officers and stockholders of the corporation without the consent of the creditors. Hence, an agreement made between the officers and the stockholders as to the liability of the stockholders on their stock notes, does not affect *creditors.*[3]

§ **4156. Corporation a Party to Suit in Equity.** — The corporation is a necessary party to a bill in equity brought by a creditor of the corporation against its officers and stockholders.[4]

§ **4157. Liability of a Director for Allotting Shares to his Own Infant Children.** — A contract by an infant to take shares in a company is not void, but voidable, by the infant on attaining his majority.[5] If the company is wound up before that time, the infant cannot be made a contributory, but the person who has entered into the necessary covenants for him may become such.[6] If shares have been allotted to an infant, and no person has executed such covenants for him, and the company is wound up before his majority, then it is obvious that no one can be made a contributory in respect of those shares, and a greater burden is thus thrown upon the other shareholders. If a director has procured or connived at the allotting of shares to an infant, or to any other person who cannot be made to respond to the liability of a shareholder, he has clearly been guilty of a breach of trust, and ought to make good the loss which the company has thus sustained.[7]

[1] See, for instance, National Bank *v.* Texas Investment Co., 74 Tex. 421; *s. c.* 6 Rail. & Corp. L. J. 373; 12 S. W. Rep. 101.

[2] *Ante,* § 2951.

[3] Peychaud *v.* Hood, 23 La. An. 732.

[4] Deerfield *v.* Nims, 110 Mass. 115.

[5] *Ante,* § 1096.

[6] *Ante,* § 3273.

[7] Ex parte Wilson, L. R. 8 Ch. 45; *s. c.* 42 L. J. (Ch.) 81; 27 L. T. (N. S.) 597.

CHAPTER LXXXIII.

STATUTORY LIABILITY OF DIRECTORS AND OFFICERS TO CREDITORS.

Art. I. In General. §§ 4163–4178.
II. What Debts of the Corporation Are Within Such Statutes. §§ 4182–4201.
III. Liability Attaches to What Directors in Respect of the Date of the Debts Being Contracted. §§ 4206–4213.
IV. Liability for Debts Contracted Before Organization. §§ 4216–4219.
V. Statutory Liability for Failing to File Certain Reports. §§ 4221–4236.
VI. Liability for Making False Reports. §§ 4240–4255.
VII. Liability for Debts Contracted in Excess of a Prescribed Limit. §§ 4259–4280.
VIII. Liability for Certain Prohibited Loans. §§ 4285, 4286.
IX. Liability for Declaring Unlawful Dividends. §§ 4288–4295.
X. Miscellaneous Liabilities and Penalties. §§ 4298–4306.
XI. Remedies and Procedure Under these Statutes. §§ 4308–4348.
XII. Defenses to Such Actions. §§ 4354–4372.

Article I. In General.

Section
4163. General nature of this liability.
4164. These statutes penal and to be strictly construed.
4165. View that such statutes are not penal.
4166. Such statutes not enforced outside the State enacting them.
4167. Cases in which this doctrine applied.

SECTION
4168. Effect of a repeal of the statute upon accrued rights.
4169. Whether right of action dies with creditor.
4170. Effect of constitutional provision that "dues from private corporations shall be secured in such manner as shall be prescribed by law."
4171. Validity of a statute imposing a liability after the persons sought to be charged become directors.
4172. Effect of a dissolution of the corporation.

SECTION
4173. Sense in which directors jointly liable.
4174. Meaning of "jointly and severally liable."
4175. What if the act was of such a nature that it could not be done by a single director.
4176. Creditor may proceed against one or more.
4177. Theory that under statutes making both the innocent and the guilty liable, all must be joined.
4178. Example of a statute imposing a several liability.

§ 4163. General Nature of This Liability. — There exists in the United States a large body of statutes making the directors or trustees of corporations, as they are variously called, liable to pay the debts of the corporation which have been contracted by them during the period of certain official defaults. Turning to some of the principal of these statutes, we find that they make directors responsible: 1. For the debts contracted on behalf of the corporation before a certain prescribed amount of the capital stock, as limited or fixed by or under the governing statute, has been actually paid in.[1] 2. For debts contracted on behalf of the corporation during the period when they are in default in the making and filing or publishing of certain reports required by statute, as to the condition of the company.[2] 3. For debts of the corporation contracted after making and filing or publishing such reports, knowing them to be false.[3] 4. For debts contracted on behalf of the company in excess of certain prescribed limits.[4] 5. For declaring and paying dividends when the company is insolvent, or when there is no surplus to divide.[5] It is to be observed that the liability created by these statutes is *to creditors:* the policy of these statutes being to secure greater safeguards to

[1] *Post,* § 4216, *et seq.*
[2] *Post,* § 4221, *et seq.*
[3] *Post,* § 4240, *et seq.*
[4] *Post,* § 4259, *et seq.*
[5] *Post,* § 4288, *et seq.*

the public in dealing with incorporated companies. But sometimes the Legislatures have thought fit to impose a statutory liability upon directors for the benefit of shareholders; and this gives us a sixth class, hereafter considered. **6.** Liability to shareholders for official mismanagement.[1]

§ 4164. These Statutes Penal, and to be Strictly Construed.— These statutes are generally regarded as *penal* statutes, and an action upon them is an action for a penalty.[2] It is so held of statutes making the trustees of a corporation liable for *failing to publish an annual report* of its financial condition,[3] and of statutes imposing a personal liability upon the directors whenever the *debts* of the corporation *exceed* a prescribed limit, to the extent of such excess.[4] They are hence to be *construed strictly;* but whilst this is so, nothing short of

[1] *Post*, § 4479, *et seq.* Examples of *comprehensive statutes* embracing this ground of liability may be seen in the following: Supp. to Gen. Stats. Mass., vol. I., p. 810 (ch. 224, Acts 1870), § 38; Supp. to Gen. Stats. Mass., vol. II., p. 557 (ch. 230, Acts 1877), § 1; Cal. Penal Code, § 560; Comp. Laws Utah, 1876, p. 634, § 321; Rev. Stats. N. Y. (Banks & Bros., 6th ed., 1876), vol. II., p. 297, § 1; *Ibid.*, p. 298, § 10.

[2] Wiles *v.* Suydam, 64 N. Y. 173 (reversing *s. c.* 3 Hun (N. Y.), 604; 6 Thomp. & C. (N. Y.) 292); Adams *v.* Mills, 60 N. Y. 533; Garrison *v.* Howe, 17 N. Y. 458; Rorke *v.* Thomas, 56 N. Y. 559; Bird *v.* Hayden, 1 Robt. (N. Y.) 383; Vincent *v.* Sands, 11 Abb. Pr. (N. S.) (N. Y.) 366; Dabney *v.* Stevens, 10 Abb. Pr. (N. S.) (N. Y.) 39; *s. c.* 40 How. Pr. 341; Merchants' Bank *v.* Bliss, 35 N. Y. 412; affirming *s. c.* 1 Robt. (N. Y.) 391; McHarg *v.* Eastman, 7 Robt. (N. Y.) 137; Esmond *v.* Bullard, 16 Hun (N. Y.), 65; Price *v.* Wilson, 67 Barb. 9; Kritzer *v.* Woodson, 19 Mo. 327; Union Iron Co. *v.* Pierce, 4 Biss. (U. S.) 327; Sturges *v.* Burton, 8 Ohio St. 215; *s. c.* 72 Am. Dec. 582; Gregory *v.* German Bank, 3 Col. 332; *s. c.* 25 Am. Rep. 760; Stebbins *v.* Edmands, 12 Gray (Mass.), 203; Irvine *v.* McKeon, 23 Cal. 472; Nassau Bank *v.* Brown, 30 N. J. Eq. 478, 484; Hall *v.* Sigel, 7 Lans. (N. Y.) 206; *s. c.* 13 Abb. Pr. (N. S.) (N. Y.) 178; Cameron *v.* Seaman, 69 N. Y. 396; *s. c.* 25 Am. Rep. 212; Verona &c. Co. *v.* Murtaugh, 50 N. Y. 314; Miller *v.* White, 50 N. Y. 137; Derrickson *v.* Smith, 27 N. J. L. 166, 176 (construing the New York statute); Craw *v.* Easterly, 4 Lans. (N. Y.) 513; Gadsden *v.* Woodward, 103 N. Y. 242. Compare *ante*, § 3013, *et seq.*, and § 3052.

[3] Gregory *v.* German Bank, 3 Col. 332; *s. c.* 25 Am. Rep. 760. The Colorado statute is identical with that of New York which is also held penal in its nature, in many of the cases from that State just cited. So held in Steam-Engine Co. *v.* Hubbard, 101 U. S. 188.

[4] Irvine *v.* McKeon, 23 Cal. 472; Sturges *v.* Burton, 8 Ohio St. 215, 221; *s. c.* 72 Am. Dec. 582.

a substantial compliance with the statute will exonerate the trustees. Thus, a statute which requires a report to be signed by the president and a majority of the trustees and verified by the president and secretary, is not satisfied by a report signed and verified by the secretary exclusively, and does not exonerate the trustees.[1] But this rule of strict construction does not mean that the judges are at liberty to fly in the face of the Legislature, and to treat such statutes in an unfriendly spirit, or, by a species of *judicial legislation*, to *repeal* them in any particular. They are bound, in administering them, to keep in view the *paramount principle* of statutory interpretation and administration, — that it is the duty of the judge in all cases to construe a statute so as to discover and give effect to the intention of the Legislature, as gathered from the language used. The rule, in its just application, goes no further than to *impose a caution* upon the judges against extending the statute to cases not plainly within its language. In fact the doctrine that certain statutes are to be construed strictly seems to be a relic of a barbarous age, when the judges, unmindful that it was not their office to legislate, opposed an unfriendly interpretation to all statutes that created innovations upon the common law — that is, upon the law which the judges themselves had made. It is also to be observed that this doctrine was in its fullest bloom when the House of Commons did not even represent the popular will, as indeed it does now but imperfectly, and when, as now, the House of Lords represented nobody but the lords themselves. The doctrine seems to have no just place at all in an entirely free government based upon universal suffrage. In such a government it is not the province of the judiciary to oppose to any extent the operation of the laws which the people through their representatives have made, whether those laws are wise or unwise, gentle or severe, — saving, of course, the case where the act of the Legislature is opposed to the fundamental law; but it is the duty of the judges faithfully to administer whatever laws the Legislature has enacted, and not to assume to

[1] Vincent *v.* Sands, 11 Abb. Pr. (N. S.) (N. Y.) 366, 373.

expand one law by what is called a "liberal," and to restrain another by what is called a "strict," construction. Judges who assume any other office simply oppose the will of the people, in excess of their jurisdiction, and contrary to the spirit of their official oaths. It is further submitted that the doctrine of strict construction, if it has any just existence at all, has no just application to the statutes under consideration. By the principles of the common law, all men are answerable out of their estates for the debts which they contract, by themselves or by their agents. That is the general rule, and that is what is called "common right." The grant of corporate privileges, carrying with it an exemption from this rule, is a grant contrary to common right, and is hence to be strictly construed, under another application of this same doctrine of strict construction.[1] Now, when the Legislature says that the managing officers of corporations shall not enjoy this granted immunity, provided they enter upon the business of the corporation before a certain amount of capital stock has been subscribed and paid in, or provided they contract debts in excess of a certain prescribed limit, or provided they fail to make and publish certain reports to apprise the public of its financial condition, — it is no more than to say to them that these things which it requires of them are conditions precedent upon which alone they shall enjoy this granted immunity. That is the true theory; that is a sound application of the maxim that grants of corporate privileges are to be construed strictly in favor of the public and against the grantees; and the only meaning of the principle is that whatever is *doubtful* is not granted. But the judges, while professing to follow this rule of interpretation, have completely reversed it in this, as in other instances, — illustrating a judicial habit of forgetting the rights of the scattered and isolated people and playing into the hands of incorporated money and power.[2]

[1] *Post*, §§ 5345, 5659.

[2] This doctrine of strict construction is not itself so strict that it cannot be let down on any convenient occasion. Such statutes as those under consideration can be "penal"

§ 4165. View that Such Statutes are not Penal. — The better view has sometimes been taken that such statutes are not regarded as creating penalties or as giving actions for penalties, but rather as a measure of security for the public, and not within the statute of limitations relating to penalties.[1] But yet in a later case the court said, it being a statutory remedy it was to be pursued strictly; and in the same case it was said that this statutory obligation, though not technically a contract, was an obligation *quasi ex contractu.*[2]

§ 4166. Such Statutes not Enforced Outside the State Enacting Them. — It is a rule of law that statutes imposing penalties and forfeitures will not be enforced outside the territory of the sovereign by whose Legislature they were enacted. The barbarous and tribal conceptions in vogue at the time when our American constitution was established placed the respective States, in respect of questions of *inter-state law,* in the attitude of *foreign nations* in friendly intercourse with each other. The rule has hence obtained that the courts of one of these States will not enforce the penal legislation of another of them,[3] though it is of course at liberty to do so whenever, by so doing, it will advance its own

for one purpose, and not "penal" for another. Thus, an action against a director of a manufacturing corporation to recover a debt of the corporation, claimed to be due from the director by reason of his failure to file the annual report required by statute, is an action to recover a *penalty,* in such a sense that, under another statute, defendant is not required to *verify his answer.* Gadsden *v.* Woodward, 103 N. Y. 242. On the other hand, such a statute does not impose a "*fine*" or "*penalty,*" in the sense in which those terms are used in another statute (N. Y. Code, § 549, subd. 1), so as to subject the party to *arrest.* Glen's Falls Paper Co. *v.* White, 58 How. Pr. (N. Y.) 172. Again, it has been held that an action brought against the directors of a corporation, to charge them individually with a debt of the corporation, which, as against the corporation, rested in contract, is to be regarded as an action upon a contract. Durant *v.* Gardner, 10 Abb. Pr. (N. Y.) 445; *s. c.* 19 How. Pr. (N. Y.) 95.

[1] Neal *v.* Moultrie, 12 Ga. 104.

[2] Banks *v.* Darden, 18 Ga. 318, 340.

[3] Story Confl. Laws, §§ 620, 621; Whart. Confl. Laws, § 853, *et seq.;* Rorer Interstate Law, 148; Scoville *v.* Canfield, 14 Johns. (N. Y.) 338; *s. c.* 7 Am. Dec. 467; United States *v.* Lathrop, 17 Johns. (N. Y.) 4.

local policy.[1] The rule is a rule of narrow, tribal jealousy, and when applied to a collection of sister States, in a close political union, is at once destitute of sense and justice. In such interstate relation, the true limit of the rule is that one State will not enforce the penal laws of another State, when the enforcement of such laws is opposed to its own policy or injurious to its own citizens. Nevertheless, the principle has been adopted without any seeming restriction, that the courts of one State will not enforce the statutes of another State, of the kind which we are considering;[2] and this notwithstanding the fact, which will fully appear before the close of this chapter, that such statutes exist in nearly every State of the Union. Judges have adhered to this rule with such narrow and blind persistency that they have refused to enforce such statutes, when to do so would result in protecting their own citizens against loss occasioned by the wrong-doing of directors of foreign corporations. This statement may be illustrated by a case where it was sought to enforce in Maryland a statute of Pennsylvania, which provided that the directors and officers of corporations, contracting any liability in excess of the capital actually paid in, should be jointly and severally liable in their individual capacities for the amount of such excess, which might be recovered of them in an action of debt. It was held that the liability thus imposed was in the nature of a penalty, which could not be enforced outside the limits of the State imposing it.[3] But the author has already submitted reasons why the courts should never have held

[1] Waite *v.* Ferguson, 14 Abb. Pr. (N. S.) (N. Y.) 379, is suggested as an example of this.

[2] Derrickson *v.* Smith, 27 N. J. L. 166; Bird *v.* Hayden, 1 Robt. (N. Y.) 383; *s. c.* 2 Abb. Pr. (N. S.) (N. Y.) 61; Price *v.* Wilson, 67 Barb. (N. Y.) 9; Attrill *v.* Huntington, 70 Md. 191; *s. c.* 14 Am. St. Rep. 344 (*s. c. reversed* on a Federal question, 146 U. S. 657); First Nat. Bank *v.* Price, 33 Md. 487; *s. c.* 3 Am. Rep. 204; Flash *v.* Conn, 16 Fla. 428; *s. c.* 26 Am. Rep. 721.

[3] First Nat. Bank *v.* Price, 33 Md. 487; *s. c.* 3 Am. Rep. 204. The dissent of two judges (Stone and McSherry, JJ.), in a subsequent case in the same court where the same doctrine was applied, shows a much juster conception of the subject. Attrill *v.* Huntington, 70 Md. 191; *s. c.* 14 Am. St. Rep. 344; 16 Atl. Rep. 651.

that the liability thus created is in the nature of a penalty. Such a statute should be construed *in pari materia* with the charter of the particular company, or the other provisions of the general law (if such there be) under which it is organized. Its effect, so construed, is simply this: the Legislature says to a number of coadventurers,—you may collect a certain fund, and trade with that fund and hold it out to the public as the exclusive stake on which you solicit and obtain credit; but you shall do this only on the condition that you do not contract debts in excess of that fund — that is to say, debts beyond the means of payment possessed by the body which is made alone responsible. If you contract debts in excess of that amount, then you, the managers who do this, shall be answerable personally. Such a statute has all the features of a remedial statute, designed to protect the public who deal with corporations against the consequences of the mismanagement and rascality of their managers. Such a statute goes no further than to make the managers of a corporation guarantors for the corporation of the payment of debts which they are forbidden to contract in its behalf. That such a statute should be enforced by every other State for the benefit of its own citizens, or even for the benefit of the citizens of other States or countries, is obvious justice, and no argument to the contrary can be derived from the mere jargon of calling it a penal statute. This view has been lately taken by the Supreme Court of the United States, reversing the Court of Appeals of Maryland, in a case above cited;[1] and this decision is binding as an authority on the State courts wherever the liability has been established by *judgment* in the State of the corporation.

§ 4167. Cases in Which This Doctrine Applied. — Within this rule are statutes making the directors of corporations jointly and severally liable for the debts of the company, contracted during a time when such directors are in default in not obeying a statute requiring them to make and file in some

[1] Huntington *v.* Attrill, 146 U. S. 657; reversing *s. c.* 70 Md. 191.

public office certain reports concerning the condition of the corporation, for the information of the public.[1] So, of statutes making them liable for contracting or assenting to the contracting of corporate debts beyond the amount of capital paid in;[2] or making stockholders liable to pay the debts of the company in case of a failure to give a certain notice therein specified,[3] or liable for certain contracts of the corporation which it is forbidden by statute to make.[4] Where the president of a railroad company, organized under the laws of Illinois, had become liable under the laws of that State to pay a debt of the corporation, in consequence of making a false affidavit to the certificate of incorporation of the company, he could not maintain an action to charge a stockholder, in one of the courts of New York; since, if he were to recover, the effect of the recovery would be to subrogate the defendant to the right of action which creditors had against the plaintiff for this wrong, and thus the plaintiff and defendant might go on suing each other indefinitely.[5] So, a statute of New York[6] providing that "if any certificate or report made or public notice given, by the officers of any such corporation, shall be false in any material representation, all the officers who have signed the same shall be jointly and severally liable for all the debts of the corporation contracted while they are officers thereof," was not enforceable in Maryland, even though judgment had first been obtained in New York.[7]

§ 4168. Effect of a Repeal of the Statute upon Accrued Rights.—It is familiar law that there can be no vested right in the recovery of a penalty given by statute; that the repeal of a statute giving a penalty obliterates the statute as effec-

[1] Bird *v.* Hayden, 1 Robt. (N. Y.) 383; 2 Abb. Pr. (N. S.) (N. Y.) 61; Derrickson *v.* Smith, 27 N. J. L. 166; Halsey *v.* McLean, 12 Allen (Mass.), 438; *s. c.* 90 Am. Dec. 157.

[2] First Nat. Bank *v.* Price, 33 Md. 487; *s. c.* 3 Am. Rep. 204.

[3] Cable *v.* McCune, 26 Mo. 371; *s. c.* 72 Am. Dec. 214.

[4] Lawler *v.* Burt, 7 Ohio St. 340.

[5] Wait *v.* Ferguson, 14 Abb. Pr. (N. Y.) 379.

[6] New York Laws, 1875, ch. 611, § 21.

[7] Attrill *v.* Huntington, 70 Md. 191; *s. c.* 14 Am. St. Rep. 344; 2 L. R. A. 779; 16 Atl. Rep. 651; 21 Chic. Leg. N. 248; but reversed on error, 146 U. S. 657.

tually as though no such statute had ever been passed; and that all rights of action which have accrued under such a statute, even though suits to enforce the same have been commenced, are, by such repeal, wholly determined, unless the repealing act, by its terms, saves pending suits.[1] When it is conceded that statutes of the kind we are considering in this chapter are penal, it of course follows that this rule applies to them. The question has, however, been decided both ways: some courts taking the view that these statutes are penal in the strict sense which brings them within the operation of this rule,[2] others holding that they raise a liability *quasi ex contractu*,[3] while still others hold that they are remedial.[4] The latter rule obtains as to statutes imposing upon *the stockholders* of corporations an individual liability to pay the corporate debts. Such statutes are not regarded as penal, and when creditors give credit to the corporation they are deemed to give it on the faith of them. A repeal of such a statute, in so far as it attempts to operate upon existing rights is, within the meaning of the constitution of the United States, a law impairing the obligation of contracts, and is, therefore, void.[5]

[1] Yeaton *v.* United States, 5 Cranch (U. S.), 281; Norris *v.* Crocker, 13 How. (U. S.) 429; Stephenson *v.* Doe, 8 Blackf. (Ind.) 508; *s. c.* 46 Am. Dec. 489; Butler *v.* Palmer, 1 Hill (N. Y.), 324; State *v.* Youmans, 5 Ind. 280; Miller's case, 1 W. Black. 451; Lewis *v.* Foster, 1 N. H. 61; Oriental Bank *v.* Freese, 18 Me. 109; *s. c.* 36 Am. Dec. 701; People *v.* Livingston, 6 Wend. (N. Y.) 526; Com. *v.* Welch, 2 Dana (Ky.), 330; Allen *v.* Farrow, 2 Bailey (S. C.), 584; Pope *v.* Lewis, 4 Ala. 487; Schooner Rachel *v.* United States, 6 Cranch (U. S.), 329; United States *v.* Preston, 3 Pet. (U. S.) 57.

[2] Breitung *v.* Lindauer, 37 Mich. 217; Union Iron Co. *v.* Pierce, 4 Biss. (U. S.) 327; Gregory *v.* German Bank, 3 Col. 332; *s. c.* 25 Am. Rep. 760. The court, speaking through Thatcher, C. J., say: "Inchoate rights arising under the statute were swept away. No right can be said to have *accrued* to creditors under the statute, unless, before its repeal, such right was carried into judgment. There is no such thing as a vested interest in an unenforced penalty: Sedgw. Stat. Law, 111; Norris *v.* Crocker, 13 How. (U. S.) 429; Gaul *v.* Brown, 53 Me. 496; Curtis *v.* Leavitt, 15 N. Y. 152; Nichols *v.* Squire, 5 Pick. (Mass.) 168; Bay City &c. R. Co. *v.* Austin, 21 Mich. 390." There is a note on this subject in 19 Am. & Eng. Corp. Cas. 112.

[3] Banks *v.* Darden, 18 Ga. 318, 340.

[4] Hargroves *v.* Chambers, 30 Ga. 580, 601.

[5] Hawthorne *v.* Calef, 2 Wall. (U. S.) 10; Conant *v.* Van Schaick, 24 Barb. (N. Y.) 87; Rochester *v.* Barnes, 26 Barb. (N. Y.) 657; Story *v.* Fur-

§ 4169. Whether Right of Action Dies with Creditor. — It has been held that a statute of New York[1] making a director of a corporation liable for corporate debts and liabilities on signing a *false certificate* or report, being *penal* in its nature, the right of action thereon *dies* with the creditor.[2] This decision was by the City Court of the city of New York. One of the departments of the Supreme Court of that State has held that, where a plaintiff, in an action under a similar statute,[3] had obtained a judgment which, on appeal to the general term, was reversed and a new trial ordered, after which he died, the action *did not abate*, but might be revived by his personal representatives, for the purpose of an appeal to the Court of Appeals.[4] It should be carefully noted that many of the statutes provide in express terms for a survival of the action, by giving it against *executors and administrators*.

§ 4170. Effect of Constitutional Provision that "Dues from Private Corporations shall be Secured in Such Manner as shall be Prescribed by Law." — The existence of a provision in the constitution of the State that "dues from corporations, other than banking, shall be secured by such individual liability of the corporators, or other means, as may be prescribed by law," *does not render the Legislature incompetent to repeal* a statute making the directors of corporations liable to pay the corporate debts in consequence of failure or refusal to file certain reports therein prescribed. The provision quoted leaves to the Legislature a wide discretion as to the manner in which it will secure such dues, and permits it to alter or repeal any legislation it may have enacted to this end, at pleasure.[5] The author inclines to think that the provision quoted leaves the Legislature free to repeal wholly all legislation which may have been enacted for this purpose, if in its discretion it shall see fit.[6]

man, 25 N. Y. 214, 223; Norris *v.* Wrenschall, 34 Md. 492, 501; Thompson on Stockholders, §§ 71, 72.

[1] N. Y. Laws, 1875, ch. 611, § 21.

[2] Dalton *v.* Goodwin, 5 N. Y. Supp. 257.

[3] N. Y. Laws, 1848, ch. 40, § 12.

[4] Carr *v.* Risher, 5 N. Y. Supp. 371.

[5] Union Iron Co. *v.* Pierce, 4 Biss. (U. S.) 327, 335.

[6] See, however, Bull *v.* Conroe, 13 Wis. 233; Parker *v.* King, 16 Wis. 223; Martin *v.* Hughes, 67 N. C. 293, 296; Tuttle *v.* Strout, 7 Minn. 465; *s. c.* 82 Am. Dec. 108; Cogel *v.* Mickow, 11 Minn. 475; Coleman *v.* Ballandi, 22 Minn. 144, 147; Noble *v.* Hook, 24 Cal. 638. Compare Sparger *v.* Cumpton, 54 Ga. 355; Harris *v.* Glenn, 56 Ga. 94; Hawthorne *v.*

That such provisions exist in many of the State constitutions has already been seen.[1]

§ 4171. Validity of a Statute Imposing a Liability after the Persons Sought to be Charged Become Directors.—It is not a good objection to a statute making the directors of a bank primarily liable for its debts in the event of its insolvency, that the act was passed after the directors sought to be charged under it became directors of the bank, provided the indebtedness, in respect of which it is sought to charge them, was created subsequently to the passage of the act, they being directors at the time. In such a state of circumstances, the act has none of the incidents of an *ex post facto* law.[2] This is analogous to the doctrine, already considered,[3] that a State statute, or constitutional ordinance, imposing a personal liability upon stockholders, may be applied to corporations already existing, where the right to amend their charter has been reserved, without violating the provision of the Federal constitution against impairing the obligation of contracts.[4] Suppose the Legislature passes an act to organize and regulate banking associations, in which it reserves to itself the power to "alter or amend the act, and to dissolve any association to be incorporated under its provisions, by a vote of two-thirds of each House." Suppose the Legislature afterwards passes an amendatory act making the liability of directors more onerous than before, what will be the effect of this amendatory act? It will not make guilty any acts of bank directors done before its passage, which were then innocent, nor will it attach additional liability to such acts. But if, by the terms of the first statute, the fact of insolvency fixed the liability of the directors, and if a particular bank became insolvent before

Smith, 3 Nev. 182; *s. c.* 93 Am. Dec. 397.

[1] *Ante*, § 2998, *et seq.*

[2] Falconer *v.* Campbell, 2 McLean (U. S.), 195, 213; *s. c.* 10 Myer Fed. Dec., § 15.

[3] *Ante*, § 3034.

[4] Matter of Lee & Co.'s Bank, 21 N. Y. 9; Matter of Reciprocity Bank, 22 N. Y. 9; Sherman *v.* Smith, 1 Black (U. S.), 587. Compare Matter of Empire City Bank, 18 N. Y. 199; *s. c.* 8 Abb. Pr. (N. Y.) 192.

the amendatory act took effect, then the liability of the directors was subject to its provisions.[1]

§ **4172. Effect of a Dissolution of the Corporation.** — It is now well settled that the debts of a corporation do not die with the corporation, but may still be enforced by proper proceedings;[2] but even if it were otherwise — as it was once by the common law — this, it has been held, would not determine a right of action given by statute to creditors against directors for official defaults.[3]

§ **4173. Sense in Which Directors Jointly Liable.** — The subject of joint and several liability is apt to be very confusing, unless we separate from the question of the liability itself the question of the *procedure* by which it is enforced. When the books say that A. and B. are jointly liable, they in general refer merely to the fact that A. and B., having committed the same wrong, may be proceeded against jointly for the damages; but they do not mean that, where A. and B. are associated together for a particular object, if A. commits a wrong, B. is answerable for it. Thus, in the case of directors A., B., and C., composing a quorum of the board, unite in doing a certain act for which the statute makes them jointly liable to creditors of the company. This means no more than that the creditors may proceed against them all in one action. It does not mean that, if the wrongful act was really committed by A. and B., and C. dissented from it, C. will nevertheless be liable for the wrong of A. and B. There is nothing in the relation of directors which imposes such a liability. They are not answerable for each other's acts as partners, nor are they guarantors of each other's good conduct.[4] The contrary rule would be a rule of obvious injustice, and it does not exist in any case, except where it has been established by the positive terms of statutes.[5]

[1] White *v.* How, 3 McLean (U. S.), 111.

[2] *Ante*, § 3341; *post*, ch. 156.

[3] Hargroves *v.* Chambers, 30 Ga. 580, 606.

[4] McMaster *v.* Kohner, 12 Jones & Sp. (N. Y.) 253; Irvine *v.* McKeon, 23 Cal. 472.

[5] As to this see *post*, § 4177.

§ 4174. Meaning of "Jointly and Severally Liable." — The expression "jointly and severally liable," which is frequently met with in statutes such as we are considering, does not mean, then, that the directors are mutually liable for each other's wrongs; but it means that those directors who have committed a common wrong may be jointly sued for it; and that, at the same time, the wrong remains so far the wrong of each one singly, that he may, at the election of the person injured, be called upon to answer for it severally. Under a statute making use of this expression, it is supposed that the directors may be sued jointly, a general judgment obtained against them, and levied upon their joint property, if they have any; or that they may be jointly sued, and judgment obtained against any one of them, and levied upon his individual estate; or that two or more of them may be joined, and the judgment which may be obtained against them levied upon their joint property, if they have any, or upon the separate property of either; or that a joint judgment obtained against some, or all of them, may be levied upon the separate property of any one of them; or that, if a suit is brought against some of them and the process is not served upon all, it may be dismissed as to those upon whom it is not served, and may proceed to judgment as to the others.[1]

§ 4175. What if the Act was of Such a Nature that It could not be done by a Single Director.—It was said in one case, by an eminent judge, that there may be certain acts which, from their very nature, cannot well be committed by a single director, such as declaring a dividend, or discounting paper. Where a statute prohibits the declaring of a *dividend* where there are no profits to divide, or the *discounting* of a certain kind of paper, a declaration against a single director, without the joinder of enough of the others to have constituted a *quorum* of the board, could not, it was thought, be sustained.[2] It would seem, however, that there must be excep-

[1] See Quigley *v.* Walter, 2 Sweeny (N. Y.), 175, and cases cited.

[2] Gaffney *v.* Colvill, 6 Hill (N. Y.), 567, *per* Bronson, J. See, *contra*, Hill *v.* Frazier, 22 Pa. St. 320.

tions to this statement of doctrine, even if it could be accepted as a rule. Thus, one director may usurp the powers of the board, or the whole management of the company may be committed to him by the other directors, in violation of their duty, as is often the case; in which case they might not be answerable for his violation of the statute to the same extent as he is answerable, though they would be liable for negligence on grounds already set out.[1] But where the act was of such a nature that it could not be done by a single director, it was held that, in *declaring* against one, it was necessary to allege that he had the *concurrence of others* in doing the act;[2] but why it is necessary so to aver, the opinion does not state, nor are we able to perceive.

§ 4176. Creditor may Proceed against One or More.— Where the liability is thus made *joint and several*, the creditor may bring his action against one or more or all, at his election or convenience; and where he does not join all, the non-joinder of the others will be no defense,[3] or ground of *abatement*.[4] One reason given for this conclusion is that the liability arises *in tort*, and that there is no right of *contribution* among joint tort-feasors.[5] Even if a right of contribution existed, this would not alter the rule; for it would not result therefrom that the creditor would be obliged to levy his execution ratably upon the property of each of the directors against whom his judgment is recovered.[6] The true reason is that no one can rightfully claim that another shall be joined as defendant with him in an action for tort.[7] Therefore, in a suit by a creditor of a bank against the two *surviving directors*, upon the ground that all the directors became individually

[1] *Ante*, § 4111.

[2] Gaffney *v.* Colvill, *supra.*

[3] Strong *v.* Sproul, 4 Daly (N. Y.), 326; *s. c.* reversed on other grounds, 53 N. Y. 497; Patterson *v.* Stewart, 41 Minn. 84; *s. c.* 16 Am. St. Rep. 671; 42 N. W. Rep. 926.

[4] Andrews *v.* Murray, 33 Barb. (N. Y.) 354. Compare Colburn *v.* Patmore, 1 Cromp., Mees. & R. 73; Hargroves *v.* Chambers, 30 Ga. 580, 588.

[5] Andrews *v.* Murray, *supra.* As to the right of *contribution*, see *post*, § 4376, *et seq.*

[6] Hargroves *v.* Chambers, *supra.*

[7] Strong *v.* Sproul, 4 Daly (N. Y.), 326.

liable by violating the charter, it was not necessary to *join* the representatives of the deceased directors.[1] As the creditor is at liberty to single out any offending director and proceed against him alone, it follows that the *corporation need not be joined* with him as a co-defendant.[2]

§ 4177. Theory that, under Statutes Making Both the Innocent and the Guilty Liable, All must be Joined.—The charter of a bank in Georgia contained this provision: "The total amount of debts which the said corporation shall at any time owe, whether by bond, bill, note, or other security, shall not exceed three times the amount of their capital stock actually paid in, over and above the amount of specie actually deposited in the vaults for safe-keeping. In case of excess, *the directors under whose administration it shall happen* shall be liable for the same in their private and individual capacities, and may be sued for the same in any court of record in the United States, by any creditor of the corporation,—any condition, covenant, or agreement to the contrary notwithstanding. But it shall not be so construed as to exempt the said corporation, or the lands, tenements, goods, and chattels of the same from being liable for and chargeable with the said excess."[3] A severe construction was put upon this statute. It was held to make all the directors liable, although some of them may have been absent, or, if present, voting or protesting against the act in violation of the statute. It followed that the liability was *joint*, and not several, and that in any action under the statute, all the directors must be joined, unless a sufficient averment was made showing why this could not be done.[4] By the statutes of Michigan[5] a majority of the directors of certain corporations are required to make certain

[1] Hargroves *v.* Chambers, *supra.*

[2] Hill *v.* Frazier, 22 Pa. St. 320.

[3] Prince Dig. Ga. Stat. 127. In addition to the cases cited to special points, the liability of directors under these statutes was enforced in Robinson *v.* Bealle, 20 Ga. 275, and in Schley *v.* Dixon, 24 Ga. 273; *s. c.* 71 Am. Dec. 121.

[4] Banks *v.* Darden, 18 Ga. 318, 334, 340.

[5] Comp. Laws Mich. 1857, ch. 63, §§ 19, 23.

reports and to file them with the clerk of the county, and an action is given against *all* the directors jointly, in case of an intentional neglect to perform this duty. A director, in office during the period of such default, cannot defend an action brought against him by showing that the neglect was not that of himself, but that of his co-directors; the statute makes all liable, those who are innocent as well as those who are guilty.[1]

§ **4178. Example of a Statute Imposing a Several Liability.** Where a statute, after prohibiting the doing of certain things by directors of moneyed corporations, provided that *every* director who should violate or be concerned in violating any provision of the preceding sections of this article, should be liable personally, etc., this, it was held, was sufficient to make *any* director liable singly for any of the prohibited acts.[2]

Article II. What Debts of the Corporation Are Within Such Statutes.

Section
4182. Liability for torts.
4183. Mere gratuities.
4184. Security debts.
4185. Debts founded in fraud.
4186. Debts due the directors themselves.
4187. *Ultra vires* debts.
4188. Certificates of deposit.
4189. Judgments and judgments for costs.
4190. Debts which have been assigned.
4191. Wages of employés.
4192. Debts payable in future.
4193. Unliquidated damages for breaches of contract.
4194. Taxes.
4195. Debts barred by limitation: obligation of lessee to pay taxes.
4196. Renewals.
4197. Debts contracted and due in other States.
4198. Debts due to participants in the wrongs denounced by the statute.
4199. Debts due a partnership dissolved by death.
4200. Simple contract debts.
4201. Obligation to pay a guaranteed dividend.

§ **4182. Liability for Torts.** — From the rule that statutes making the directors of corporations liable on account of certain official failures for the debts of the company are

[1] Van Etten *v.* Eaton, 19 Mich. 187. But see Franklin Ins. Co. *v.* Jenkins, 3 Wend. (N. Y.) 130.

[2] Gaffney *v.* Colvill, 6 Hill (N. Y.), 567.

deemed penal in their nature and hence are to be strictly construed, flows the conclusion that the word "*debt*" in such a statute will not be construed so as to include *torts* committed by agents of the corporation and for which the company might be liable.[1] A statute of this kind, making the directors liable "for all debts of the company then existing and for all that shall be *contracted*," is obviously within this rule of interpretation; since a tort cannot be spoken of as a *debt* which has been *contracted*.[2] So a statute making the directors of a corporation liable for declaring and paying *dividends* while the corporation is insolvent, makes them liable only for demands against the corporation arising *ex contractu;* and if the debt has been reduced to judgment against the corporation, the bill seeking to charge the directors must so allege.[3] It has been held that the liability of a corporation for an *infringement of letters-patent* is not, before it has been reduced to a judgment, a "debt," within the meaning of statutes of Massachusetts, for which the officers of the offending corporation are individually liable. The theory of the decision is that the liability of a corporation for what may be called a *tort simplicitor*, that is, a tort which does not spring out of the breach of a contract, is not, before judgment, a debt in the sense of those statutes.[4]

[1] Chase *v.* Curtis, 113 U. S. 452; Cable *v.* Gaty, 34 Mo. 573; *s. c.* 86 Am. Dec. 126. So held under N. Y. Law, 1848, ch. 40, § 12; Kirkland *v.* Kille, 99 N. Y. 390; Esmond *v.* Bullard, 16 Hun (N. Y.), 65. The rule is analogous where the statute extends the liability *to shareholders: Ante*, § 3111; Cable *v.* McCune, 26 Mo. 371; *s. c.* 72 Am. Dec. 214; Cable *v.* Gaty, 34 Mo. 573; *s. c.* 86 Am. Dec. 126; Bohn *v.* Brown, 33 Mich. 257; Heacock *v.* Sherman, 14 Wend. (N. Y.) 58. Other courts, however, have held, in construing statutes imposing *individual liability upon stockholders* in corporations, that the word "debt" embraces claims against the corporation for *unliquidated damages*. Carver *v.* Braintree Man. Co., 2 Story (U. S.), 432, 447; Mill Dam Foundry *v.* Hovey, 21 Pick. (Mass.) 417, 455; Dryden *v.* Kellogg, 2 Mo. App. 87, 93. Compare as to the meaning of the word "debt": Dellinger *v.* Tweed, 66 N. C. 206; Conroy *v.* Sullivan, 44 Ill. 451; Lane *v.* Baker, 2 Grant's Cas. 424; Schouton *v.* Kilmer, 8 How. Pr. (N. Y.) 527; Lathrop *v.* Singer, 39 Barb. (N. Y.) 396.

[2] Esmond *v.* Bullard, 16 Hun (N. Y.), 65.

[3] Archer *v.* Rose, 3 Brewst. 264.

[4] Child *v.* Boston &c. Iron Works,

§ **1483. Mere Gratuities.**—Moreover the word "debt" in such a statute will not embrace a demand against the company created by a mere gratuity on its part. This is obvious when it is considered that the policy of a statute, requiring the directors of companies to file certain reports with a designated public officer, is to protect the public in giving it credit. When, therefore, the demand against the company was upon bonds of the company which the company had given to the plaintiff as *a gratuity*, it was held that this was no foundation on which to charge the trustees under section 12 of the New York Act, 1848.[1]

§ **4184. Security Debts.** — The liability of the principal to indemnify his surety is a "debt contracted" within the meaning of statutes, such as we are considering. It becomes a debt from the time when the surety becomes responsible for the debt to the principal, and not at the time when he actually pays such debt. Such a debt is "contracted," within the meaning of such a statute, at the time when the surety signs the note, accepts the draft, or otherwise enters into the obligation of suretyship.[2] In like manner an agreement of a corporation to *indemnify* an accommodation acceptor is a "debt contracted" at the time when such agreement is made, and not from the time when the debt is paid by the acceptor.[3] Although, for some purposes, a judgment upon a note is a *merger* of the original debt, yet it does not affect the liability of the indorser, and a suit may be maintained against him upon the note.[4] The same is true as to the liability of sureties, and of all parties whose liability is collateral to the principal debt. A judgment against the principal debtor merges the debt as to him, and it does not operate to defeat any col-

137 Mass. 516; *s. c.* 50 Am. Rep. 328. Compare Matter of Boston &c. Iron Works, 23 Fed. Rep. 880; *ante*, § 3111.

[1] Norris *v.* De Wolf, 12 Hun (N.Y.), 666.

[2] Rice *v.* Southgate, 16 Gray (Mass.), 142; Byers *v.* Franklin Coal Co., 106 Mass. 131, 136.

[3] Byers *v.* Franklin Coal Co., *supra.*

[4] Gilmore *v.* Carr, 2 Mass. 171; Porter *v.* Ingraham, 10 Mass. 88; Ward *v.* Johnson, 13 Mass. 148.

lateral concurrent remedy against other parties which the creditor may have.[1] Within this principle falls the case of an *accommodation acceptor* for a corporation. The corporation is the principal debtor, primarily liable for the debt evidenced by a draft; the liability of the stockholders is secondary and collateral. A judgment obtained by the holder of the draft merges his debt as to the corporation; as to the stockholders, it does not merge it, so as to deprive the plaintiff of the remedy which the statute gives him to enforce their collateral liability.[2]

§ **4185. Debts Founded in Fraud.**—It is scarcely necessary to suggest that, under a statute of this kind, directors can only be made liable for *bona fide* debts of the corporation, and not for debts imposed upon it by fraud. It was so held where the debt was for a loan of money made by the wife of the secretary of the corporation, who was himself a trustee of the corporation, at *usurious* rates of *interest*, the secretary having no authority to borrow money for the company, and he and the treasurer concealing the transaction from the other trustees. The husband's knowledge of the illegality of the transaction was imputed to the wife of the plaintiff.[3] But it is no defense that the debt was originally a debt due to the secretary of the company, who assigned his judgment for the debt to the plaintiff, and that the *failure of the directors to make the report* required by the statute was owing to the secretary's own willful and fraudulent neglect. The reason for this conclusion is derived from the terms of the statute,[4] which exact a report from the trustees, and devolve the duty of making it upon them.[5]

§ **4186. Debts Due the Directors Themselves.** — Neither are debts due from the corporation to one of its directors or

[1] Campbell *v.* Phelps, 1 Pick. (Mass.) 62; *s. c.* 11 Am. Dec. 139; Byers *v.* Franklin Coal Co., 106 Mass. 131, 137, *per* Morton, J.

[2] Byers *v.* Franklin Coal Co., *supra.*

[3] Adams *v.* Mills, 60 N. Y. 533.

[4] N. Y. Stat. 1848, ch. 40, § 12. See the appendix.

[5] Bolen *v.* Crosby, 49 N. Y. 183.

trustees within the meaning of such a statute; because directors cannot by their own wrong create a cause of action in favor of themselves, and because the contrary rule would operate to cut down the fund which the statute has created for the security of creditors other than the wrong-doers.[1] Therefore, an assignee of a debt created by the corporation, while its trustees were in default in the making of a report required by such a statute, could not maintain an action to charge the trustees for the same, if it appeared that the debt was assigned to him by some of the trustees who were in office at the time of the default, in whose favor it was then created. The trustee himself could not have recovered, and he could not create in his assignee a higher right than he himself had.[2]

§ **4187. Ultra Vires Debts.**—Where the plaintiff is a corporation, and where the contract out of which the debt against the corporation grew has been executed by the plaintiff—as where the plaintiff has delivered goods under a contract, so that it is entitled to its pay for them, it will be no defense that the contract out of which the debt grew was *ultra vires* the plaintiff corporation; since, if the defendants are solicitous that the shareholders of the plaintiff corporation should not suffer loss in consequence of the unauthorized act of their agents, they can prevent this result by paying the debt. Such defense ought never to be allowed, except in case of contracts which are prohibited by positive law.[3] But where this element of equitable estoppel does not supervene—where the debt for which it is sought to make the directors liable was

[1] Thacher *v.* King, 156 Mass. 490; *s. c.* 31 N. E. Rep. 648; McClave *v.* Thompson, 36 Hun (N. Y.), 365.

[2] Briggs *v.* Easterly, 62 Barb. (N. Y.) 51. Under a statutory provision that the officer of a corporation making a false certificate shall be liable for all the debts of the corporation contracted while he is an officer or stockholder, such liability extends to a debt contracted by the corporation in favor of the officer during that period, so that he cannot recover upon it from the stockholders. Wait *v.* Ferguson, 14 Abb. Pr. (N. Y.) 379.

[3] Whitney Arms Co. *v.* Barlow, 63 N. Y. 62; *s. c.* 20 Am. Rep. 504; reversing *s. c.* 6 Jones & Sp. (N. Y.) 554; Patterson *v.* Stewart, 41 Minn. 84; *s. c.* 16 Am. St. Rep. 671; 42 N. W. Rep. 926.

created by the officers of the debtor corporation in plain breach of their trust, to which breach of trust the creditor was privy, or of which he had notice when he gave the credit, then the trustees of the corporation cannot be made liable in respect of such a debt, by reason of their failure to file the *annual report* required by a statute. The reason of the rule is, that the debt is one which cannot be enforced against the corporation itself;[1] and such being the case, it makes no difference that the offending directors may have created the debt. The general rule under this head seems, therefore, to be that debts which are *ultra vires* in such a sense that they cannot be enforced against the corporation, cannot be enforced, under statutes of the kind under consideration, against the directors; and it is said that the liability of the directors is measured by the obligation of the company, and that the remedy against them is concurrent.[2]

§ **4188. Certificates of Deposit.**—Under a statute making the directors of a corporation jointly liable whenever the *debts* of the corporation, "whether by bill, bond, note, or other security," should exceed a given amount, they were liable where the debt was evidenced by a *certificate of deposit;* because it created a debt and constituted a *security*, within the meaning of the language quoted. Nor was any weight given to the argument that the funds paid into the bank for which the certificate was issued, balanced the liability created by the certificate; since such funds went into the general moneys of the bank, and were not in the nature of a special deposit.[3]

§ **4189. Judgments and Judgments for Costs.**—A judgment existing at the time of such a statutory default has been held to be a "debt" within the meaning of the statute.[4] A

[1] National Park Bank *v.* Remsen, 43 Fed. Rep. 226; *s. c.* 8 Rail. & Corp. L. J. 457.

[2] Jones *v.* Barlow, 62 N. Y. 202; Rector &c. *v.* Vanderbilt, 98 N. Y. 170, 173; Gold *v.* Clyne, 134 N. Y. 262, 265.

[3] Hargroves *v.* Chambers, 30 Ga. 580.

[4] Lewis *v.* Armstrong, 8 Abb. N. Cas. (N. Y.) 385. Compare *post*, § 4206, *et seq*, as to the *time* of the debt being contracted.

judgment for costs has been held to be a "debt" within such a statute.[1] On the contrary, a judgment upon a *scire facias* has been held not to be a "debt contracted," within the meaning of such a statute;[2] nor is a recovery of a judgment for damages for *tort*.[3] Although the recovery of a judgment against a corporation extinguishes the debt as to it, such recovery does not affect the penal liability of a trustee for the amount of such debt, under a statute making trustees of manufacturing companies liable for neglecting to file an annual report.[4]

§ **4190. Debts Which have been Assigned.** — The *assignment* of a debt owned by a corporation carries with it a right to enforce such a liability against the directors.[5] So, an *assignment of a judgment* against the corporation carries with it the right to enforce such a liability against the directors.[6] This being so, all the incidents of an assignment of a *chose in action* follow. After an assignment had been made and the directors notified of it, it would not be competent for them, or any one of them, to compound with the assignor and procure a release of the liability from him, which would be valid as against the assignee.[7] It has been held that where the directors are made by statute liable to any creditor, and a stockholder *redeems the bills* of the bank, he becomes a creditor, and the directors are liable therefor to him; hence a release of the directors is a release of the stockholders in such a case.[8] And

[1] Allen *v.* Clark, 108 N. Y. 269; *s. c.* 15 N. E. Rep. 387; reversing *s. c.* 43 Hun (N. Y.), 377; Allen *v.* Clark, 49 N. Y. St. Rep. 175; *s. c.* 21 N. Y. Supp. 338.

[2] Armstrong *v.* Cowles, 44 Conn. 44.

[3] Chase *v.* Curtis et al., 113 U. S. 452.

[4] McHarg *v.* Eastman, 7 Robt. (N. Y.) 137.

[5] Pier *v.* George, 86 N. Y. 613; reversing (on another point) *s. c.* 20 Hun (N. Y.), 210; Bonnell *v.* Wheeler, 16 Abb. Pr. (N. S.) (N. Y.) 81; Allen *v.* Clark, 49 N. Y. St. Rep. 175; *s. c.* 21 N. Y. Supp. 338.

[6] Bolen *v.* Crosby, 49 N. Y. 183.

[7] *Ibid.* That the assignment of a judgment necessarily carries with it the debt, see Jackson *v.* Blodget, 5 Cow. (N. Y.) 202; Rose *v.* Baker, 13 Barb. (N. Y.) 230; Green *v.* Hart, 1 Johns. (N. Y.) 580; Pattison *v.* Hull, 9 Cow. (N. Y.) 747; Gallarati *v.* Orser, 4 Bosw. (N. Y.) 94; Thomas *v.* Hubbell, 35 N. Y. 120.

[8] Robinson *v.* Bealle, 20 Ga. 275.

although statutes of this kind do not extend to the absurdity of making the directors personally liable for debts of the corporation due to the directors themselves,[1] yet where the corporation owes a debt to one of its directors, evidenced by a *negotiable instrument*, and the director *assigns* the instrument to an *innocent purchaser* for value, the rule which protects the innocent purchaser of *ultra vires* commercial paper of corporations[2] operates to protect him in this instance, and to enable him to enforce a statutory liability against the directors for failure to file an annual report.[3]

§ **4191. Wages of Employés.** — An obligation assumed by *contract* to pay an employé a stated salary is of course a "*debt*," within the meaning of such a statute.[4] But services, in order to constitute a "debt" within such a statute, must have been rendered *upon request;* and it has been held that, in an action founded on the failure of the trustees of a manufacturing corporation to file an annual report, a failure to allege that the services for which plaintiff asks compensation were rendered at the request of the corporation, is fatal.[5]

4192. Debts Payable in Future. — To charge a trustee of a manufacturing corporation for its debt, no report having been filed, the debt must have been so contracted as to give *a present right of action* against the corporation.[6]

§ **4193. Unliquidated Damages for Breaches of Contract.** — It seems that such statutes do not include *unliquidated damages* for *breaches of contract*.[7]

[1] *Ante*, § 4186.

[2] *Post*, §§ 5737, 6068.

[3] Chemical Nat. Bank *v.* Colwell, 14 Daly (N. Y.), 361; 14 N. Y. St. Rep. 682.

[4] Brand *v.* Godwin, 3 N. Y. Supp. 807; *s. c.* 8 N. Y. Supp. 339.

[5] Tovey *v.* Culver, 54 N. Y. Super. Ct. 404. As to the liability of *stockholders* (and of course *directors*) for "labor debts" under statutes, see *ante*, § 3141, *et seq.*

[6] Vernon *v.* Palmer, 62 How. Pr. (N. Y.) 425.

[7] Victory Web Printing &c. Co. *v.* Beecher, 26 Hun (N. Y.), 48.

§ **4194. Taxes.** — A *tax* duly assessed against the corporation, and presently payable, is a "*debt*," within the meaning of such a statute.[1]

§ **4195. Debts Barred by Limitation: Obligation of Lessee to Pay Taxes.** — Of course, a *debt barred by limitation* is not *revived* by a penal statute, so as to be enforced against persons other than the original debtor. It has been held that where a lessee agrees to pay the taxes assessed on the leased property, or to pay the amount to the lessor on a certain day afterwards, no debt is due to the lessor until the day named. In three years from that day the bar of the statute of limitations attaches. After the bar has attached, it follows that there is no debt on the basis of which the trustees of the lessee corporation can be charged for a default in filing an annual report of the condition of the corporation.[2]

§ **4196. Renewals.** — As already seen,[3] the theory of the New York courts is, that such a statute does not apply to *renewals*, unless the debt, as renewed, and as sued upon, was a subsisting debt at the time of the default in complying with the statute; so that, by accommodating the corporation at the request of the defaulting directors, the creditor may succeed in *renewing his debt out of existence*, so far as any means of enforcing it remains. But the mere *liquidation* of the debt by the company, and *payment* thereof in its promissory notes, does not cancel the indebtedness, and does not affect the liability of the trustees.[4] It has been held that where a corporation note is merely a renewal and consolidation of items of previous indebtedness, the liability of those who were

[1] Felker *v.* Standard Yarn Co., 148 Mass. 226; *s. c.* 19 N. E. Rep. 220.

[2] Trinity Church *v.* Vanderbilt, 98 N. Y. 170.

[3] *Ante*, § 3117.

[4] Deming *v.* Puleston, 35 N. Y. Super. Ct. 309; *s. c.* affirmed, 55 N. Y. 655; Jones *v.* Barlow, 38 N. Y. Super. Ct. 142; *s. c.* affirmed, 62 N. Y. 202. But note a decision of a subordinate court to the effect that where, after the filing of a false certificate for which the directors are liable under a statute, *renewal notes* are given for a debt contracted prior to the filing of the certificate, the directors are personally liable for it under the statute: Fergerson *v.* Gill, 46 N. Y. St. Rep. 474; *s. c.* 19 N. Y. Supp. 149.

directors when such note was given does not attach, as in the case of a debt originally accruing during their direction.[1]

§ 4197. Debts Contracted and Due in Other States.—The liability of trustees of a corporation organized under the New York Manufacturing Corporation Act, for debts of the corporation, where an annual report is not filed, extends to debts contracted and due in other States, as well as to debts contracted and due in New York.[2]

§ 4198. Debts Due to Participants in the Wrongs Denounced by the Statute.—As we have seen,[3] the *directors themselves* cannot, in their character of creditors, enforce a personal liability against themselves, founded on their own wrong in violating a statute of the kind under consideration; and this rule extends to *others who participate* in the wrong denounced by the statute. Not quite upon this principle, but upon the principle of *acquiescing* in the wrongful act of the directors, was a case where a statute made the directors of railroad companies, receiving taxes voted in aid of its road, liable to the stockholders for incumbering the road beyond a prescribed limit, in case it should operate to reduce the value of its stock. This was designed to protect the stockholders who had become such by receiving, under statutes, shares of stock in railway companies, in exchange for taxes paid by them in aid of such railroads. It was held that it did not apply so as to enable stockholders, who had become such by receiving shares for taxes paid *after the recording of a mortgage* securing an indebtedness in excess of the statute,—for the reason that, under those circumstances, the tax-payer might have resisted the payment of the tax on the ground of the excessive mortgage, and was therefore deemed to have acquiesced in it.[4]

[1] Sullivan *v.* Sullivan Man. Co., 24 S. C. 341. And the old directors are not to be charged the higher rate of interest stipulated for in the renewal note. *Ibid.*

[2] Sears *v.* Waters, 44 Hun (N. Y), 101.

[3] *Ante,* § 4186.

[4] Walker *v.* Birchard, 82 Iowa, 388; *s. c.* 48 N. W. Rep. 71.

§ 4199. Debts Due a Partnership Dissolved by Death.— It has been held that a surviving partner may enforce a statutory liability against directors, for the making of a false certificate in respect of a debt created in favor of the partnership firm prior to the death of his co-partner, the reason being that each partner is, in theory of law, the owner of the whole of the partnership assets; and that in case of the death of one partner there is no devolution of title.[1]

§ 4200. Simple Contract Debts.— In a proceeding in equity under a statute of Massachusetts,[2] making the directors of corporations personally liable for debts in excess of the capital, the plaintiffs may not only prove their judgment debt, but any further sum due them by *simple contract.*[3]

§ 4201. Obligation to Pay a Guaranteed Dividend.— One court has held that the obligation assumed by a corporation issuing *preferred stock*, to pay semi-annually a dividend guaranteed by it upon that stock, is not a *debt*, within the meaning of a statute of the kind under consideration, after the company becomes *insolvent* and suspends business, so that there are no profits out of which a dividend can be declared and paid.[4] The reasoning of the court is, that an obligation to declare a dividend when there are no profits to divide is not a "debt" within the meaning of such a statute; but it ignores the fact that the company *guaranteed* a dividend, and that the contract did not say that the guaranty was based on the contingency that there should be profits to divide. The obvious meaning of the contract was that the company guaranteed that there should be profits to divide; and how the court could interpret this guaranty that there would be profits to divide to the extent of five per cent per annum, as not creating a debt, is past understanding.[5]

[1] Fergerson *v.* Gill, 46 N. Y. St. Rep. 474; *s. c.* 19 N. Y. Supp. 149.

[2] Pub. Stats. Mass., ch. 106, § 60, cl. 3.

[3] Thacher *v.* King, 156 Mass. 490; *s. c.* 31 N. E. Rep. 648.

[4] Lockhart *v.* Van Alstyne, 31 Mich. 76; *s. c.* 18 Am. Rep. 156.

[5] As to the effect of such guaranties in favor of preferred shareholders, see *ante*, § 2275, *et seq.*

Article III. Liability Attaches to What Directors in Respect of the Date of the Debts Being Contracted.

Section
4206. Liability attaches only to those directors in office at the time of the default.
4207. Illustrations.
4208. Where the statute enjoins the making of a particular financial statement or report.
4209. Such as the New York Manufacturing Corporations Act.
4210. Where the statute prohibits the contracting of particular debts.
4211. Whether liable for debts contracted before the doing of the prohibited act.
4212. When the debt is deemed contracted "after such violation."
4213. Conclusiveness of action of creditor in fixing date of debt.

§ 4206. Liability Attaches only to Those Directors in Office at the Time of the Default. — Liability under statutes for official defaults obviously attaches only to those directors who were in office when the particular misprisions were committed: the rule being, that each one stands liable to or exempt from the particular liability, accordingly as he did, or did not, participate in the particular wrong.[1] This is the general rule in regard to the liability of stockholders,[2] though there are exceptions to it.[3] There may be an exception to it in cases where directors who succeed those who committed the wrong do acts which amount to a ratification, or a continuing of it — just as one person may be liable as the author, and another as the continuer, of a nuisance.[4] The same view was taken where the question arose under a special charter providing that "this company shall not at any time contract debts exceeding three-fourths the amount of its capital paid in; and

[1] Schley *v.* Dixon, 24 Ga. 273, 279; *s. c.* 71 Am. Dec. 121; Bank of Mutual Redemption *v.* Hill, 56 Me. 385; *s. c.* 96 Am. Dec. 470.

[2] Moss *v.* Oakley, 2 Hill (N. Y.), 265; Judson *v.* Rossie Galena Co., 9 Paige (N. Y.), 598; *s. c.* 38 Am. Dec. 569; Tracy *v.* Yates, 18 Barb. (N. Y.) 152; Adderly *v.* Storm, 6 Hill (N. Y.), 624; Harger *v.* McCullough, 2 Den. (N. Y.) 119; McCullough *v.* Moss, 5 Den. (N. Y.) 567; Mokelumne &c. Co. *v.* Woodbury, 14 Cal. 265; Davidson *v.* Rankin, 34 Cal. 503; Larrabee *v.* Baldwin, 35 Cal. 155; Williams *v.* Hanna, 40 Ind. 535.

[3] Thompson on Stockholders, ch. VI.

[4] Moses *v.* Ocoee Bank, 1 Lea (Tenn.), 398.

if such indebtedness shall exceed the amount aforesaid, the directors and stockholders shall be personally holden to the creditors of said company." This did not charge with liability for the debts of the company those who were directors and stockholders at the time of the bringing of the suit, but those who were such *at the time the debt was contracted,* if the statute was then being infringed by them.[1]

§ **4207. Illustrations.** — Thus, under a statute of Indiana,[2] requiring of gravel-road companies that a financial statement shall be "made out . . . . within fifteen days after the first day of July in each year," — only those in office *at the time fixed* for the statement are liable for the failure to make it.[3] . . . . Under the rule of the preceding section, if there is a default to publish the reports required by the statute, on the 20th of January, and a director comes into office on the 27th of January, and resigns on the 20th of August, he will be responsible for a debt of the company contracted on July 6th.[4] . . . . The directors of a corporation, whose terms of office began after an indebtedness had been created against the corporation, and after default had been made by the previous board in failing to file, as required by law, a report showing the amount of the corporate indebtedness, are not liable, under a statute of Colorado,[5] which provides "that all the directors or trustees of the company shall be jointly and severally liable for all the debts of the company that shall be contracted during the year next preceding the time when such report should . . . . have been made and filed, and until such report shall be made."[6]

§ **4208. Where the Statute Enjoins the Making of a Particular Financial Statement or Report.** — Where the statute enjoins, as many statutes do, the making and publication of a particular report or financial statement on a particular date, those *who are directors at that date* and who fail to comply with the statute, incur the liability denounced by it, — as, for

[1] Windham Prov. Inst. *v.* Sprague, 43 Vt. 502.

[2] Ind. Rev. Stat., § 3638.

[3] State *v.* Cox, 88 Ind. 254.

[4] Chandler *v.* Hoag, 5 Thomp. & C. (N. Y.) 197; *s. c.* 2 Hun (N. Y.), 613.

[5] Gen. Stat. Col., § 252.

[6] Austin *v.* Berlin, 13 Col. 198; *s. c.* 22 Pac. Rep. 433.

instance, where the statute requires an annual report to be made, and makes the directors jointly and severally liable for the debts contracted during the year, in case it is not made.[1] Where the language of the statute, or its judicial construction, admits a *locus penitentiæ*, so to speak, — that is, allows the directors to stop the running of the penalty by doing the act at a future time, — then, it has been held that the liability will attach only to those directors who were in office, (1) during the period of the default, (2) within which period the debt must have been contracted. In other words, if the statute says to the directors of a corporation, "You shall publish a certain financial statement on a given day, or be jointly and severally liable for the debts of the company," the directors in office, who allow that date to pass without publishing the required statement, contract any debts in behalf of the corporation during the period of the default at the peril of having to pay them personally, — that is, until by making the statement (which, it seems, they may curatively do at a future date), they place themselves right before the law.[2] It will follow from this that if a director *goes out of office* during the period of default, he will be liable only for those debts which were contracted during the period of default and *while he was in office*.[3] On the other hand, a director *coming into office after the default* is only liable for such debts as are contracted while he is in office, and before a report is made and published.[4] So, under a statute of Wisconsin, it is necessary for a bill in equity, to charge directors for failing to make a certificate required by statute,[5] to allege that the indebtedness to the plaintiff was contracted *after such refusal* and *before* the making of any subsequent annual statement.[6] It would seem to be equally

[1] Austin *v.* Berlin, 13 Col. 198; *s. c.* 4 Denv. Leg. News. 338.

[2] McHarg *v.* Eastman, 7 Robt. (N. Y.) 137; Garrison *v.* Howe, 17 N. Y. 458.

[3] Shaler &c. Co. *v.* Bliss, 27 N. Y. 297; affirming *s. c.* 34 Barb. (N. Y.) 309; Quarry Co. *v.* Bliss, 12 Abb. Pr. (N. Y.) 470; Andrews *v.* Murray, 33 Barb. (N. Y.) 354; Squires *v.* Brown, 22 How. Pr. (N. Y.) 35.

[4] Boughton *v.* Otis, 21 N. Y. 261; Shaler &c. Co. *v.* Brewster, 10 Abb. Pr. (N. Y.) 404.

[5] Rev. Stat. Wis., ch. 73, § 23.

[6] Seaman *v.* Goodnow, 20 Wis. 27.

clear that where a liability has thus attached in respect of particular debts contracted during the period of default, the directors cannot throw off the liability by the retrospective act of filing the report in respect of which they were in default, — as by filing the annual report for a previous year after the debts in respect of which it is sought to charge them have accrued.[1] And if, after the time of an election has passed, a former trustee *holds over*, and continues to act as trustee, he becomes personally liable upon failure to file a report for debts of the company.[2] But if, at the expiration of his term, a trustee retires from the company, and afterwards performs no official act, and assumes no official authority, he cannot be held liable as trustee for the omission to make and file such a report.[3]

§ 4209. Such as the New York Manufacturing Corporations Act. — Restating this somewhat complicated question with reference to the provisions of the New York statute relating to manufacturing corporations,[4] it will be observed that this statute requires such corporations to make certain reports within twenty days from the 1st of January of each year, in default of which "all the trustees of the company shall be jointly and severally liable for all the debts of the company *then existing*, and for all that shall be contracted before such report shall be made." This statute is held to impose a personal liability upon all trustees *in office*, for all corporate debts contracted while they are in office, there being a default in the particular named, but not for debts contracted after their retirement from office. Under it, a trustee coming into office after default is personally liable for such debts only as are contracted while he is in office, and before a report is made and published; but if he resign the office, he is not liable for debts of the company in consequence of the subsequent default of the trustees to make and file the report required by the statute.[5] Thus, the board of trustees guilty of the default in January, and retiring from office, are liable for all antecedent debts, and for those only; their successors, if they

[1] Duckworth *v.* Roach, 8 Daly (N. Y.), 159.

[2] Deming *v.* Pulston, 35 N. Y. Super. Ct. 309; Reed *v.* Keese, 37 N. Y. Super. Ct. 269.

[3] Reed *v.* Keese, *supra.*

[4] Laws N. Y. 1848, ch. 40, § 12.

[5] Squire *v.* Brown, 22 How. Pr. (N. Y.) 35.

continue in default until the next January, and no longer, are liable for debts afterwards contracted during that year, and for no other.[1] In order to charge a trustee under this statute, three things must concur in point of time: the trusteeship, the default to publish the reports required by the statute, and the contracting of the debt.[2] In a case decided in the New York Superior Court in 1871, Freedman, J., expressed the following opinion concerning the meaning of the statute: "1. Upon the default of the company to report, all the trustees then in office are jointly and severally liable for *all* the debts of the company then existing, whether contracted by them or their predecessors, and for all that may be subsequently contracted during their continuance in office until such report is made. 2. Trustees who, upon such default, retire from office, are liable for all debts of the company then existing, but for no subsequent ones. 3. Their successors, by promptly obeying the requirements of the statute, may escape all liability; but, if they continue the default until the next January, they are liable for the debts contracted during their administration up to that time, and for no other, unless they then and there make default, in which latter case they become liable for *all* debts then existing. 4. Thus, the members of successive boards of trustees may become liable for the same debts by reason of successive defaults."[3] The statute makes directors, who are guilty of the default mentioned, liable "for all debts then existing." This is said to be a distinct liability from the liability which the statute also imposes for debts "afterwards contracted." The meaning of the statute is said to be, that the trustees of a corporation which shall omit to make its annual report, who are in office at the time of such omission, shall be liable for all debts existing at the time, *whenever contracted*, and shall be further liable for all debts which may be contracted after such time, during their continuance in office, and until such report is filed.[4] As, by the terms of the

[1] Boughton *v.* Otis, 21 N. Y. 261; Shaler &c. Co. *v.* Bliss, 27 N. Y. 297; affirming *s. c.* 12 Abb. Pr. (N Y.) 470.

[2] Shaler &c. Co. *v.* Bliss, 27 N. Y. 297. So ruled under Rev. Stat. Conn., § 404, p. 172; Prov. Steam-Engine Co. *v.* Hubbard, 101 U. S. 188; *s. c.* 12 Chic. Leg. N. 143.

[3] Vincent *v.* Sands, 11 Abb. Pr. (N. S.) (N. Y.) 366, 371; citing Boughton *v.* Otis, 21 N. Y. 261; Shaler &c. Co. *v.* Bliss, 27 N. Y. 297; affirming *s. c.* 34 Barb. (N. Y.) 309, and 12 Abb. Pr. (N. Y.) 470; Garrison *v.* Howe, 17 N. Y. 458; Miller *v.* White, 57 Barb. (N. Y.) 504; *s. c.* 8 Abb. Pr. (N. S.) (N. Y.) 46; Nimmons *v.* Hennion, 2 Sweeny (N. Y.), 663.

[4] Nimmons *v.* Hennion, 2 Sweeny (N. Y.), 663.

statute, the directors guilty of the default become liable for all debts "then existing," if the default occurs *after the creditor's* death, they become personally liable to his *executor*.[1] Under a later and similar statute of the same State,[2] it is reasoned that a director, who is in default by reason of failing to make the *annual report* required by the statute, becomes personally liable for a debt of the corporation the moment the same is contracted.[3] But the liability, under another section of the same statute,[4] for signing and filing a *false report*, is held to attach only in respect of corporate debts contracted *subsequently* to the time of filing the report and while the director continues in office.[5]

§ 4210. Where the Statute Prohibits the Contracting of Particular Debts.—Where the statute prohibits the directors from contracting particular debts, such as *debts in excess of a given limit*, then its obvious construction would attach liability only to those directors guilty of the prohibited act. Thus, where the statute[6] prohibits directors from contracting debts beyond the amount of the solvent stock of the corporation, a member of a former board is not liable for a contract made by his successors.[7] So, in an action brought against a director under the California statute,[8] the plaintiff must prove that the debts were contracted under the administration of the defendant, and that he was "present when the same did happen."[9]

§ 4211. Whether Liable for Debts Contracted before the Doing of the Prohibited Act.—Of course, it is not the policy of any of these statutes that the innocent should suffer the penalty for the acts of the guilty; and so it has been held that subsequent directors and stockholders of a bank are not liable

[1] Carley *v.* Hodges, 19 Hun (N. Y.), 187.

[2] N. Y. Laws, 1875, ch. 611.

[3] Chapman *v.* Comstock, 58 Hun (N. Y.), 325; *s. c.* 34 N. Y. State Rep. 517; 11 N. Y. Supp. 930.

[4] N. Y. Laws, 1875, ch. 611, § 21.

[5] Young *v.* Godwin, 19 N. Y. Supp. 656; Woods *v.* Godwin, 19 N. Y. Supp. 658; Ashley *v.* Godwin, 19 N. Y. Supp. 658.

[6] Here, Ind. Rev. Stat. 1876, p. 654.

[7] Schofield *v.* Henderson, 67 Ind. 258. This obvious principle of justice would apply in any relation: Schley *v.* Dixon, 24 Ga. 273; *s. c.* 71 Am. Dec. 121.

[8] Cal. Corp. Act of 1850, § 14; Wood's Dig. Cal. Stat., p. 116.

[9] Irvine *v.* McKeon, 23 Cal. 472.

for the fraud of their predecessors, in issuing bills for circulation before the amount of stock required by the charter has been paid up in specie, if they do not participate in it; but otherwise, if they continue the fraud by reporting to the public authorities, from time to time, that the requisite amount has been paid.[1] So, it has been held that one who purchases stock in a banking association cannot maintain an action against a director of the association for violations of the statute relating to moneyed corporations which occurred *before* he became a stockholder, although the value of the stock is depreciated by reason of such violations of the statute.[2] So, a trustee of a moneyed corporation in New York will not be held liable personally for a debt of the corporation, upon the ground of wrongful acts of the defendant committed before the corporation incurred any obligation to the plaintiff; but in order to sustain a recovery, it should appear that the plaintiff was a creditor of the corporation *at the time* the violation of the law is alleged to have been committed.[3] On the contrary, it is held that a provision of the statute of Massachusetts,[4] that officers knowingly making a *false certificate* of the condition of the corporation shall be "liable for *its debts*," cannot be limited to debts incurred *afterwards*.[5] And, as already seen, under the New York Manufacturing Corporations Act, the directors guilty of the default become liable "for all debts then existing."[6] Of course, the decision turns in each case upon the language of the particular statute. Thus, under the statute of Connecticut,[7] the president and secretary must annually make a certificate showing the condition of the affairs of the corporation on the first day of January or July next preceding, setting forth the amount of capital actually paid in, the cash value of its credits, the amount of its debts, etc.; and, on neglecting to comply, they are jointly and sever-

[1] Schley *v.* Dixon, 24 Ga. 273; *s. c.* 71 Am. Dec. 121.

[2] Mabey *v.* Adams, 3 Bosw. (N. Y.) 346.

[3] Ogden *v.* Rollo, 13 Abb. Pr. (N. Y.) 300.

[4] Mass. Pub. Stat., ch. 106, § 60.

[5] Felker *v.* Standard Yarn Co., 148 Mass. 226; *s. c.* 19 N. E. Rep. 220.

[6] *Ante*, § 4209.

[7] Conn. Rev. Stat., p. 172, § 404.

ally liable to an action founded on the statute for all debts of such corporation contracted *during the period of such neglect or refusal.* In an action by a creditor of such corporation against its president, a strict construction of the statute required the court to hold that the defendant was not liable, if the debt was contracted by the corporation before, although it might remain unpaid during the period when he neglected or refused to comply with the requirements of the statute.[1]

§ 4212. When the Debt is Deemed Contracted "After Such Violation." — A more difficult question has arisen under a statute declaring that "if any corporation, organized and established under the authority of this act, shall violate any of its provisions, and shall thereby become insolvent, the directors ordering or assenting to such violation shall be jointly and severally liable, in an action founded on this statute, for all debts contracted *after such violation* as aforesaid."[2] Here it was held that where a *series of acts* or a *continuous course of conduct*, on the part of the directors, in violation of the statute, finally producing the insolvency of the corporation, is begun before the debt of a creditor is contracted, the debt is not contracted "after such violation," although the series of acts or course of conduct is not completed, or the insolvency of the corporation consummated, until afterwards.[3]

§ 4213. Conclusiveness of Action of Creditor in Fixing Date of Debt. — Where the creditor has charged against a corporation, in his books of account, the price of articles procured for them, but never delivered and accepted, as due at the time when they were ready for delivery and acceptance, and has recovered a judgment against the corporation, upon his account made up as due at that time, with interest thereafter, he cannot afterwards, in an action brought for the purpose of holding the officers of the company personally

[1] Steam Engine Co. *v.* Hubbard, 101 U. S. 188.

[2] Minn. Laws, 1873, ch. 11, § 23; Minn. Gen. Stats., ch. 34, § 42.

[3] Patterson *v.* Stewart, 41 Minn. 84; *s. c.* 16 Am. St. Rep. 671; 42 N. W. Rep. 926.

responsible therefor, aver that the debt was not due until a later date.[1]

Article IV. Liability for Debts Contracted Before Organization.

Section
4216. The mischief which these statutes were designed to remedy.
4217. Liable for making sham payments of stock subscriptions.

Section
4218. Liable for contracting debts before legal organization.
4219. Not liable on contracts made before being empowered by the by-laws.

§ 4216. The Mischief Which These Statutes were Designed to Remedy.—In the preceding title we have considered this subject with reference to the liability of shareholders.[2] We have noted in a former chapter a view that the *promoters* of corporations are not, as matter of law, liable as partners, although facts may exist making them so liable; for the reason that an agreement to enter into a partnership in future does not create a partnership *in præsenti.*[3] It has also been decided that the members of a company not fully organized as a corporation, are not liable as partners for debts contracted by the directors.[4] To obviate the injury which might accrue to the public from such rules as this, statutes exist in many of the States, making the directors and shareholders of inchoate corporations jointly and severally liable as partners, for the debts contracted for the company prior to the time when the organization of the corporation is completed in the manner pointed out by the statute.[5] The object sought to be

[1] Bond *v.* Clark, 6 Allen (Mass.), 361.

[2] *Ante,* § 2968, *et seq.*

[3] *Ante,* § 421.

[4] It is held in Massachusetts that members of a corporation, to whom a certificate of organization as a corporation has been issued by the secretary of the Commonwealth, in accordance with the statute of 1870, ch. 224, are not liable as partners before the whole of the capital has been paid in, in violation of section 32 of that statute. First National Bank of Salem *v.* Almy, 117 Mass. 476. Compare Fay *v.* Noble, 7 Cush. (Mass.) 188; Trowbridge *v.* Scudder, 11 Cush. (Mass.) 83; Pierce *v.* Bryant, 5 Allen (Mass.), 91; Lancaster *v.* Choate, 5 Allen (Mass.), 530; Haggerty *v.* Foster, 103 Mass. 17.

[5] The following is given as an example of such a statute: "The directors, trustees, and corporators, and

attained by these statutes is this: that the society shall be treated as a partnership, and that there shall be an unlimited individual liability, not only on the part of its managers, but also on the part of its members, till a joint fund has been created, of a certain prescribed amount, which will be answerable to creditors. Accordingly, some of the statutes provide that the creditors and members shall be jointly and severally liable for the company's debts till the amount of capital stock, fixed and limited by the charter, or by the articles of association, under the governing statute, has been actually paid in.[1] As these statutes involve in liability the members, as well as the directors, the subject more properly concerns the liability of stockholders; and the author has treated it in a former chapter on that subject.[2]

§ **4217. Liable for Making Sham Payments of Stock Subscriptions.**—For the directors to deposit their notes in the place of specie, in payment of the stock for which they had subscribed, was not a compliance with such a statute, but was a fraud upon the public, of the most reprehensible character, which made them liable for the corporate debts under the terms of the statute.[3]

§ **4218. Liable for Contracting Debts before Legal Organization.** — Referring to a subject already considered,[4] it may be stated generally that while it is true that mere *irregularities* in the organization of a corporation will not deprive

those empowered to participate in the profits of any corporation organized under the provisions of this chapter, shall be jointly and severally liable for all debts and responsibilities of such corporation, until the whole amount of the capital shall have been paid in, and a certificate thereof filed, as hereinbefore provided." Rev. Stats. Wis. 1878, § 1901.

[1] *Ante*, § 2983.

[2] Under a statute of this kind in California providing that the "directors and stockholders in corporations shall be jointly and severally liable for all debts contracted prior to the final organization of the company," a recovery was denied in one case, because the petition was not framed with a view to its provisions. Blanchard *v.* Kaull, 44 Cal. 440.

[3] Schley *v.* Dixon, 24 Ga. 273, 278; *s. c.* 71 Am. Dec. 121.

[4] *Ante*, §§ 226, 227, 228, 2975, *et seq.*

its officers and stockholders of the protection of its charter, and of the immunities which attach to corporators from personal liability, yet this does not hold where the organization is not in substantial conformity with the charter. On this principle, persons acting as directors of a corporation when less than the necessary amount of stock has been subscribed, and before they have acquired legal authority to create any corporate obligation, become liable for debts contracted in their pretended corporate character, although acting in good faith.[1] And generally, *promoters*, or others who make contracts for the delivery of goods or the performance of work and labor for the benefit of a corporation before its organization, make themselves personally liable in case it is not organized.[2] So, where certain members of an insolvent banking corporation, which had been in a state of suspension for sixteen years, attempted by irregular and culpable methods to galvanize it into life, and did reorganize it ostensibly, and made it the means of perpetrating a great swindle upon the public, it was held that they could not claim the immunities of its charter to shield them from personal liability.[3] But this decision may be supported upon a still broader ground, namely, that conspirators cannot claim the immunity of corporators. "If any number of persons combine, with intent to injure and defraud another, they cannot defend themselves against an action, by showing that they did the act in the character of corporators, under any charter whatever."[4] "A valid act of incorporation, or an invalid and pretended right to exercise corporate franchises, is alike powerless to secure the guilty from the consequences of their fraudulent conduct, where it has been knowingly resorted to as the mere means of chicane and imposition, and used to facilitate the work of deception and injury.

[1] Farmers' Co-op. &c. Co. *v.* Floyd, 47 Ohio St. 525; *s. c.* 21 Am. St. Rep. 826; 12 L. R. A. 346; 26 N. E. Rep. 110; 33 Am. & Eng. Corp. Cas. 218.

[2] Hub Pub. Co. *v.* Richardson, 59 Hun (N. Y.), 626; *s. c.* 37 N. Y. St. Rep. 541; 13 N. Y. Supp. 665; *ante*, § 416.

[3] Bartholomew *v.* Bentley, 1 Ohio St. 37.

[4] Vose *v.* Grant, 15 Mass. 505, 515, *per* Jackson, J.

Were it otherwise, it would be a reproach to the law."[1] As already seen, where certain persons enter into a contract, claiming to be directors of a corporation, if no such corporation really exists, such persons are individually liable on the contract, on the theory of breach of warranty of agency.[2] But all this is compatible with the conclusion that a person who knows that he is dealing with a corporation before it has made publication of its articles of incorporation, stating the amount of indebtedness which it can contract, as required by law, cannot object that the publication was not completed, although begun within the time specified.[3]

§ 4219. Not Liable on Contracts Made before being Empowered by the By-laws. — A statute of California, relating to turnpike corporations, provided as follows: "The board of directors shall exercise the corporate powers of the company, with such limitations and restrictions, and to the extent only that may be prescribed in the by-laws of the company. It is expressly understood that the directors and officers have no powers except such as are given by the stockholders in their resolutions and by-laws. The secretary shall file a copy of the by-laws and all amendments thereto with the county recorder of each county traversed by the road, for public inspection, from which filing all contracts made by directors, or any officers or agents of the company, must be entered into, under the powers and by the authority conferred by such by-laws; otherwise all such contracts shall be null and void as against the company, but valid and binding as against each and all the directors, officers, or agents, who made such contract, or did not dissent therefrom."[4] Under this statute it has been held that the *failure to file by-laws*, as required, did not make the directors personally liable on any contracts which they had made for the company, if no by-laws had been, in fact, made. Since the directors

[1] Bartholomew *v.* Bentley, 15 Ohio, 659, 666; *s. c.* 45 Am. Dec. 596; Bartholomew *v.* Bentley (in a case between the same parties), 1 Ohio St. 37, 44.

[2] Herod *v.* Rodman, 16 Ind. 241.

[3] Thornton *v.* Balcom, 85 Iowa, 198; *s. c.* 52 N. W. Rep. 190. That the authority conferred by Rev. Stat. Tex., art. 585, to dispose of unsubscribed stock does not authorize the directors to commence to do business before the stock is all subscribed, see Orynski *v.* Loustaunan (Tex.), 15 S. W. Rep. 674.

[4] Cal. Stat. 1853, p. 173, § 19.

could only be clothed with power to act by by-laws, and till the making of by-laws, their powers were dormant, they could make no contract as directors, and could not become liable under a statute for making a contract in excess of their powers.[1]

ARTICLE V. STATUTORY LIABILITY FOR FAILING TO FILE CERTAIN REPORTS.

SECTION
4221. Introductory.
4222. Time at which the debt is deemed to accrue.
4223. The same, where the contract is to deliver or receive goods.
4224. In the county or counties where the corporation may conduct its business.
4225. Meaning of "within twenty days from the first day of January."
4226. Liability contingent upon corporate indebtedness actually due.
4227. Effect of giving time to the corporation.
4228. What will excuse the filing of such a report.
4229. Need not state how much capital paid in cash and how much in property.
4230. What is a signing by a majority of the trustees.
4231. Verification.
4232. Signing.
4233. Further of the construction of the New York Manufacturing Act.
4234. Construction of other statutes.
4235. Filing a false report not equivalent to filing no report.
4236. Publication of articles of incorporation under Iowa statute.

§ **4221. Introductory.** — In many of the States there exist statutes, and even constitutional ordinances, requiring the directors or trustees of corporations to make and file, in some designated public office, or publish in some designated manner, at stated periods, reports of the condition of the company. If the directors fail to perform this duty, they are made liable to pay any debts of the company contracted during the period when they are thus in default. These statutes, which made an agent liable to pay the debts of his principal in conse-

[1] Hall *v.* Crandall, 29 Cal. 567; *s. c.* 89 Am. Dec. 64. This case, the writer submits, is incapable of vindication. The court had previously held (Hall *v.* Auburn Turnpike Co., 27 Cal. 255; *s. c.* 87 Am. Dec. 75) that the company was not liable on the note sued on; and now they held that the directors were not responsible; and thus the directors got the plaintiff's money, either for themselves or somebody else, and no one was responsible for it. The decision is so plainly opposed to sound principles and to the express language of the statute that it can scarcely be regarded as one entitled to respect.

quence of a mere non-feasance, fall within the class which are deemed *penal* and to be *strictly construed.*[1] Most of the questions which have arisen under them are of a general

[1] *Ante,* § 4164. These statutes and constitutional provisions were set out at length in the author's former work on Liability of Officers and Agents of Corporations. A mere reference to some of them will here be made: Const. of Ark., art. XVII., § 13; Ark. Dig. Stats. 1874, § 3344; *Ibid.*, § 3353; Cal. Act Apr. 1, 1876, § 2; Col. Gen. Laws 1877, § 206; Conn. Gen. Stats. 1875, p. 280, § 18; Fla. Laws 1879, ch. 3165, § 11; Ind. Stats. 1876, p. 166, § 17; Rev. Stats. Ohio 1880, § 3615 (insurance companies); Comp. Laws Mich. 1871, § 2925, subsec. 7; *Ibid.*, §§ 2988, 2989 (insurance companies); Rev. Stats. N. Y. (Banks & Bros., 6th ed., 1876), vol. II., p. 644, § 8 (insurance companies); 1 Bright. Purd. Dig. Pa. 1873, p. 797, § 31 (insurance companies); Code of Va. 1873, p. 317, § 99; p. 371, § 39 (insurance companies). Liability of *treasurers* of steam navigation companies in *Maine* for failing to publish an annual financial report: Rev. Stats. Maine 1871, p. 466, § 4. Reports to State auditor: Const. Neb. 1875, art. XI., § 1; Cod. Stats. Mont. 1871–72, p. 409, § 27; to railroad commissioner: Rev. Stats. Ohio 1880, § 253. Reports of *banking companies* to State treasurer: Rev. Stats. Wis. 1878, § 2023. Officers of gravel-road companies, etc., to publish annual financial statement: Ind. Stats. 1876, p. 673, § 2. President and directors of railroad companies liable for failing to file certificate as to road and rolling stock: Rev. Stats. Me. 1871, p. 463, § 73. Duty of *railroad companies* in Missouri to make annual report to the State auditor: Const. of Mo. 1875, art. XII., § 15. Duty of corporations generally to make and publish *financial reports:* Cod. Stats. Mont. 1871–72, p. 409, § 15. Duty of directors to file certificate that capital has been paid in: Gen. Stats. N. H., p. 283, § 20; to record certificate of increased capital: Rev. Stats. N. J. 1877, p. 182, §§ 31, 32. Manufacturing and mechanical corporations,—duty to record certificate of paid-up capital with clerk of county: Rev. Stats. N. J. 1877, p. 182, § 30. Liability of bank directors for failing to make semi-annual *financial reports:* Col. Gen. Laws 1877, § 244. Manufacturing corporations in *Rhode Island,* certificate of *payment of capital stock,* how made and recorded — penalty for failure: Gen. Stats. R. I. 1872, p. 304, §§ 2, 3. Penalty for failure of directors to submit annual *financial statement* to stockholders: Rev. Stats. S. C. 1873, p. 340, § 12. Certificate of *reduction* of *capital stock:* Rev. Stats. S. C. 1873, p. 359, § 17; of *increase* of capital stock: *Ibid.*, p. 360, §§ 24, 25. A statute of Massachusetts makes it the duty of *cashiers of banks,* under a penalty, to transmit to town clerks lists of shareholders: Gen. Stats. N. H. 1867, p. 132, §§ 1, 11; *Ibid.*, p. 283, §§ 16, 18. For other statutes of the general class under consideration, see Gen. Stats. N. H. 1867, p. 282, § 11; 2 Bright. Purd. Dig. Pa. 1873, p. 280, § 8; Rev. Stats. S. C. 1873, p. 361, § 28: *Ibid.*, p. 359, § 16; *Ibid.*, p. 360, § 23; Tenn. Acts 1875, p. 249; Gen. Stats. Vt. 1862 (appendix 1870), p. 552, §§ 56, 57, 58, 62, 63; Minn. Stats. at Large, p. 446, § 117; *Ibid.*, p. 447, § 124; Cal. Act Apr. 1, 1876, § 1; 1 Hittell's Codes & Stats. 1876, p. 617.

character, and are considered in the preceding subdivisions of this chapter.

§ 4222. Time at Which the Debt is Deemed to Accrue. — The principal question which relates distinctively to these statutory provisions, and which is not common to all statutes imposing a personal liability upon directors for official defaults, has reference to the time when the debt for which the directors may be charged is deemed to accrue.[1] If there has been a default in making the reports required by such a statute, during a particular year, and during that year a debt is contracted, and during a subsequent year, within which the directors are not in default in the making of their reports, a promissory note is given for the debt, it would seem that, for the purposes of the relief afforded the creditor by the statute, the debt ought to be deemed to have accrued *from its original inception*, and not from the making of the note. And this is obviously the correct view. The reason of the statute is, to require corporations to make such a public showing of their affairs as will enable those dealing with them to determine whether they can safely give them credit; and the mischief at which it is aimed is not done unless the credit was actually given during the period of default. Moreover, this view conforms to the general doctrine of the courts that a promissory note given for an antecedent debt is not a payment of the debt, but merely an evidence of it — an additional security.[2] But, on the ground that such statutes are highly penal,[3] it has been held that the directors will not be charged if they were not in default at the time the note was given, although they were in default at the time the debt was first contracted.[4] Subsequent cases, however, hold that if the directors are in default at the time the debt was first contracted, their liability is fixed, and is not discharged by

[1] *Ante*, § 4206, *et seq.*

[2] Freeland *v.* McCullough, 1 Denio (N. Y.), 414, 426; *s. c.* 43 Am. Dec. 685.

[3] *Ante*, § 4164.

[4] Garrison *v.* Howe, 17 N. Y. 458, 462.

the taking of a note by the creditor from the corporation.[1] Neither is such liability affected by a renewing of the note,[2] nor by the recovery of a judgment against the corporation.[3]

§ 4223. The Same, where the Contract is to Deliver or Receive Goods. — Under a contract to furnish to a corporation materials to be delivered at stated times, to be paid for in the company's notes at ninety days, it seems that the debt would be deemed to arise from the time when the materials were delivered, and not from the time when the contract was made.[4] And where the contract was to deliver a certain number of articles, and its terms were such that the vendor could not demand payment until all were delivered, the fact that some of them may have been delivered during a period of default would not be sufficient to charge the trustees for the debt, if a report was made and filed in conformity with the statute before the delivery was complete. The court proceeded upon the ground that, the statute being highly penal, the directors ought not to be charged under it with liability for an uncertain and contingent debt.[5]

[1] Deming *v.* Puleston, 3 Jones & Sp. (N. Y.) 309; *s. c.* affirmed, 55 N. Y. 655; Jones *v.* Barlow, 6 Jones & Sp. (N. Y.) 142.

[2] Breitung *v.* Lindauer, 37 Mich. 217.

[3] Vincent *v.* Sands, 1 Jones & Sp. (N. Y.) 511; *s. c.* 11 Abb. Pr. (N. S.) (N. Y.) 366; McHarg *v.* Eastman, 7 Robt. (N. Y.) 137.

[4] Garrison *v.* Howe, 17 N. Y. 458.

[5] Whitney Arms Co. *v.* Barlow, 68 N. Y. 34; *s. c.* 63 N. Y. 62; *s. c.* 20 Am. Rep. 504. In a case arising under such a statute, the suit was brought against directors upon a contract under which plaintiff sold to the corporation certain standing timber, the title to which was to vest in the corporation as fast as cut, the corporation binding itself to remove a certain quantity each year, and all within five years. The corporation failed to fulfill its contract, and the directors were made defendants because of their failure to comply with the statute requiring the *publication of the articles* of association. It was held that they were liable *only for breaches within the time covered by their neglect* to comply with the statute, and not for damages occasioned by the nonfulfillment of the contract by the corporation; and that a record of a judgment obtained in another State against the corporation for the same cause of action was admissible in evidence. Cady *v.* Sanford, 53 Vt. 632.

§ 4224. In the County or Counties where the Corporation may Conduct its Business. — The provisions of the statutes of Michigan,[1] requiring certain reports to be filed in the county or counties where the corporation may conduct its business, is, when taken in connection with the rest of the statute, construed to mean that the reports must be filed in each county in which the material business of the corporation is done.[2]

§ 4225. Meaning of "Within Twenty Days from the First Day of January." — Suppose the statute provides, as the New York Manufacturing Act did before it was amended, that the company shall "annually" make and publish a certain report "within twenty days from the first day of January," does this require the company to make such report in the *January succeeding the day of its organization*, although a year has not elapsed? Or is it entitled to wait till the first January which shall succeed after it has been in existence for a year? It has been held that it must publish the required report in the January succeeding its organization, although a year has not since elapsed; and further, that a *legislative act, construing the statute*[3] to mean otherwise, is of no validity, because it is an invasion of the power of the judicial branch of the government for the Legislature to pass a declaratory statute.[4] The Court of Appeals of New York did not, however, seem to have taken the same view of this declaratory statute.[5] The filing of a report in December and its remaining on file

[1] Comp. Laws Mich., ch. 63, §§ 5, 18, 19.

[2] Van Etten *v.* Eaton, 19 Mich. 187.

[3] N. Y. Laws 1875, ch. 510; Rev. Stats. N. Y. (Banks & Bros. 6th ed.), vol. II., p. 506, § 47. This statute *amends* and *repeals* by substitution the corresponding provision in the Act of 1848 (N. Y. Laws 1848, ch. 40, § 12), — the difference being that the corporation is relieved from filing until the lapse of a year after the filing of the certificate of incorporation: Victory Web Printing &c. Co. *v.* Beecher, 26 Hun (N. Y.), 48. Effect of the saving clause in the *proviso:* Knox *v.* Baldwin, 80 N. Y. 610. There is a similar statute in that State relating to "business corporations": *Ibid.*, vol. II, p. 793, § 18.

[4] Union Iron Co. *v.* Pierce, 4 Biss. (U. S.) 327, able opinion by McDonald, J. *Contra*, Cameron *v.* Seaman, 69 N. Y. 396; *s. c.* 25 Am. Rep. 212.

[5] See Knox *v.* Baldwin, 80 N. Y. 610.

in January is not a compliance with such a statute,[1] although the report, as filed, shows the true condition of the corporation in the month of January.[2]

§ 4226. Liability Contingent upon Corporate Indebtedness Actually Due. — The liability imposed by the New York Manufacturing Act above referred to,[3] upon trustees of manufacturing corporations organized thereunder, to pay the debts of a corporation in case of failure to file annual reports thereby required, was held subject to the same conditions and qualifications which attached to the original indebtedness; so that whatever would defeat or abate an action against the corporation might be set up as a defense by the trustees. They were only liable to an action where there were debts of the corporation actually due, and for which a present right of action existed against the corporation.[4] Accordingly, it is held that where an indebtedness of a corporation falls due during the time the trustees are in default for not making such report, for which notes are given which are *renewed*, and an action is commenced against the trustees to enforce this statutory liability prior to the maturity of a portion of the unrenewed notes, the plaintiff can only recover from the trustees the sum actually due from the corporation at the time of the commencement of the action.[5] So, where a contract has been made to erect buildings for the corporation, and the work is not completed, and payment therefor is not made until after a dissolution of the corporation, the debt is not within the statute.[6]

[1] Here N. Y. Laws 1848, ch. 40, § 12.

[2] Cincinnati Cooperage Co. *v.* O'Keeffe, 120 N. Y. 603; *s. c.* 31 N. Y. St. Rep. 912; 24 N. E. Rep. 993.

[3] N. Y. Laws 1848, ch. 40, § 12.

[4] Jones *v.* Barlow, 62 N. Y. 202; Gold *v.* Clyne, 134 N. Y. 262; *s. c.* 47 N. Y. St. Rep. 770; 31 N. E. Rep. 980; 17 L. R. A. 767; affirming *s. c.* 58 Hun (N. Y.), 419; 35 N. Y. St. Rep. 582; 12 N. Y. Supp. 531.

[5] Jones *v.* Barlow, *supra.*

[6] Gold *v.* Clyne, 134 N. Y. 262; *s. c.* 47 N. Y. St. Rep. 770; 31 N. E. Rep. 980; 17 L. R. A. 767; affirming *s. c.* 58 Hun (N. Y.), 419; 35 N. Y. St. Rep. 582; 12 N. Y. Supp. 531.

§ 4227. Effect of Giving Time to the Corporation.— The trustees are not entitled to be discharged from the obligation imposed by the New York Manufacturing Act, to pay the debts of the corporation existing at the time of a failure of the corporation to file the annual report thereby required, by the mere fact of the creditor extending further time to the corporation in which to pay the debt. The reason is, that such an extension of time is necessarily made with the assent of the trustees themselves, who in such matters represent the corporation, and consequently, assuming that they are in the position of sureties, they are not entitled to be discharged by reason of such extension;[1] for the extending to the principal debtor additional time does not discharge his sureties where they assent thereto.[2]

§ 4228. What will Excuse the Filing of Such a Report.— The text of the New York Manufacturing Act requires that the report shall not only be made and published, but that it shall be filed in the office of the clerk of the county where the business of the company shall be carried on. The construction of the statute is that the *making* and *publishing* of the report does not comply with the statute, but that it must also be *filed* as therein provided; that the trustees must make and verify the report within the time prescribed by the statute,—twenty days after the close of the year,—and that, having done this, they may file and publish it as soon thereafter as may be consistent with *reasonable diligence* and *good faith*, without incurring the penalty of the statute.[3] The fact that a company is closing up its affairs, and has ceased to do business, does not exonerate the trustees from liability for failing to file such a report,[4] but a total *abandonment* of the enterprise, either before[5] or after[6] the corporate organization was effected, may be shown

[1] Jones *v.* Barlow, 62 N. Y. 202, 207. But that the *renewal* of *notes* will have a different effect, see *ante*, §§ 2018, 3117, 4196.

[2] Wright *v.* Storrs, 32 N. Y. 691.

[3] Whitney *v.* Cammann, 137 N. Y. 342; Butler *v.* Smalley, 101 N. Y. 71; Cameron *v.* Seaman, 69 N. Y. 396; *s. c.* 25 Am. Rep. 212.

[4] Sanborn *v.* Lefferts, 58 N. Y. 179; *s. c.* 16 Abb. Pr. (N. S.) (N. Y.) 42.

[5] De Witt *v.* Hastings, 69 N. Y. 518.

[6] Losee *v.* Bullard, 79 N. Y. 404.

in defense. The filing of such a report is excused where, before the time for filing it arrives, the *object fails* for which the corporation was organized, and there is no intention to prosecute its business;[1] as where it is *adjudged a bankrupt* and its entire property has passed into the hands of an assignee in bankruptcy;[2] or where, prior to the date at which the report should be filed, an application for a receiver has been made, followed by the appointment of a receiver subsequently to such date;[3] or where the trustees pass a resolution that the corporation shall *cease to transact business,* and thereupon resign their offices to take effect at the end of their term, and do not act afterward.[4] But in the view of another court, it is not excused, although the corporation has become *insolvent* and has entirely *abandoned its business,* and all its property has been turned over to one of its trustees in satisfaction of an indebtedness, and none of its officers or trustees have exercised any corporate act or function for the period of two months, and there is no intention to resume the business of the corporation.[5] The omission thus to file the report is not excused by intrusting the duty to another who fails to perform it.[6] On the other hand, the making and filing of a report as required by such a statute, after the life of the corporation has expired by limitation, will not raise any presumption of law that statutory proceedings have been taken to extend its period of existence.[7] In short, the construction of the New York statute is, that a technical dissolution is not necessary to absolve the trustees from the duty of making, publishing, and filing such a report, but that a *de facto dissolution* or *total abandonment* will be sufficient.[8] The fact that, after the term

[1] Kirkland *v.* Kille, 99 N. Y. 390; Carraher *v.* Mulligan, 28 N.Y. St. Rep. 439.

[2] Bruce *v.* Platt, 80 N. Y. 379.

[3] First Nat. Bank *v.* Lamon, 130 N. Y. 366; *s. c.* 29 N. E. Rep. 321; 8 N. Y. Supp. 444; 29 N. Y. St. Rep. 181.

[4] Van Amburgh *v.* Baker, 81 N. Y. 46.

[5] Gans *v.* Switzer, 9 Mont. 408; *s. c.* 24 Pac. Rep. 18.

[6] *Ibid.* Whether it is excused by the existence of an *injunction:* Whitney *v.* Cammann, 137 N. Y. 342; *s. c.* 18 N. Y. St. Rep. 200.

[7] Gold *v.* Clyne, 134 N. Y. 262; *s. c.* 48 N. Y. St. Rep. 770; 31 N. E. Rep. 980; 17 L. R. A. 767.

[8] Losee *v.* Bullard, 79 N. Y. 404.

of his office had expired, and before the debt in favor of the plaintiff was contracted by the corporation, the trustee filed his petition in bankruptcy, including in his list of assets his shares of stock in the corporation, and was adjudged a bankrupt, and assigned and delivered his shares to the assignee and received his discharge, and that, after the filing of the petition in bankruptcy, he had no connection with the corporation,—has been held a good defense to an action to charge him under the New York statute.[1]

§ **4229. Need not State how much Capital Paid in Cash and how much in Property.**—It was at one time supposed that the clause of the statute requiring the report to state "the amount actually paid in" of the capital, required it to state how much was paid in in cash and how much in property.[2] But, proceeding on the ground that the statute, being penal, is to be strictly construed,[3] the court of appeals of that State, two judges dissenting, held that no liability attaches for failing so to state in such a report.[4] A statement in an annual report, that the "capital stock had been paid up in full," is sufficient to comply with this requirement.[5]

§ **4230. What is a Signing "by a Majority of the Trustees."** The statutory requirement that the report be signed "by a majority of the trustees" is complied with by the report being signed by a majority of the *acting* or *de facto* trustees, although the number of trustees composing the board may have been *irregularly reduced* from a larger number, so that the trustees

[1] Philadelphia &c. Co. *v.* Hotchkiss, 82 N. Y. 471.

[2] Accordingly, the following statement was held to be defective: "Amount of capital stock, of which all but five shares were issued for the purchase of property necessary for the business of the association, and such five shares have been paid in full, $15,000." Glen Falls Paper Co. *v.* White, 18 Hun (N. Y.), 214.

[3] *Ante*, § 4164.

[4] Bonnell *v.* Griswold, 80 N. Y. 128 (Folger and Earl, JJ., dissenting); reaffirmed in Whitaker *v.* Masterton, 106 N. Y. 277.

[5] Bonnell *v.* Griswold, 80 N. Y. 128. That an omission of the names of the owners of stock in the company will not render the officers personally liable,—see Walton *v.* Goodwin, 58 Hun (N. Y.), 87; *s. c.* 33 N. Y. St. Rep. 886; 11 N. Y. Supp. 391.

signing the report do not constitute a majority of this theoretical or *de facto* board. The governing principle is that, the stockholders acquiescing, the validity of the constitution of the board of trustees cannot be questioned collaterally by a creditor—especially in an action for a penalty—when to do so would not only in effect invalidate all the acts of the board, but also work a forfeiture of the franchises of the corporation. So held where the board, by an action plainly irregular, had been reduced from *twelve* to *nine* members, and the report was signed by six only; and it was competent for the stockholders to fix the number of the board at any number as low as three.[1] But where the certificate of incorporation was signed by seven trustees, and the annual report, filed within a year, was signed by two only, and the corporate records did not show the resignation of the others, it was held that the report did not satisfy the requirement of the statute, and that the other trustees were not relieved from liability for the corporate debts.[2] It will be recalled that the statute requires that the report shall be signed "*by the president* and a majority of the trustees." Where only a bare majority of the trustees sign, and one of them is president, this satisfies this requirement.[3]

§ **4231. Verification.**—A sworn statement of the president that the report is "true to the best of his knowledge and belief," is a sufficient verification.[4]

§ **4232. Signing.**—The annual report must be *signed* by the trustees; a signing of the trustees' names by the secretary and a verification by him will not do.[5]

§ **4233. Further of the Construction of the New York Manufacturing Act.**—The statute makes the trustees liable for

[1] Wallace *v.* Walsh, 125 N. Y. 26; *s. c.* 11 L. R. A. 166; 9 Rail. & Corp. L. J. 163; 34 N. Y. St. Rep. 426; 25 N. E. Rep. 1076; affirming *s. c.* 52 Hun (N. Y.), 328; 23 N. Y. St. Rep. 641; 5 N. Y. Supp. 351.

[2] Westerfield *v.* Radde, 12 Daly (N. Y.), 450; *s. c.* 67 How. Pr. (N. Y.) 204.

[3] Brand *v.* Godwin, 29 N. Y. St. Rep. 143; *s. c.* 8 N. Y. Supp. 339.

[4] Glen Falls Paper Co. *v.* White, 18 Hun (N. Y.), 214.

[5] Bolen *v.* Crosby, 49 N. Y. 183.

"*existing debts*" in case of neglecting to comply with its provisions. This means debts due and payable at the time the penalty attaches, and it does not include a promissory note not due until after default.[1] The fact that the company is closing up its affairs and has ceased to do business does not excuse the omission to file the report; nor does the fact that the creditor claiming the advantage of the statute is a stockholder, cognizant of the financial condition of the company.[2] But it is otherwise where the creditor is himself a trustee of the corporation; he cannot enforce against his co-trustee a forfeiture for a wrong in which he himself has participated.[3] The obligation to make and file this report and the consequent liability do not attach to a trustee by virtue of the mere fact that he has been *elected* as such; there must be evidence of an express or implied *acceptance* of the office.[4] But one who has assumed the character of trustee cannot escape the liability on the plea that he was not legally elected.[5] The debt for which the trustees may be rendered liable because of the omission of the duty required by the statute, must be a *valid debt* as against the corporation. If the obligation was *fraudulently imposed* upon the corporation, there is no personal liability;[6] and, in general, the directors may set up, in a proceeding against them to enforce this liability, any defense to which the original indebtedness was subject.[7] Only the trustees who are guilty of the negligence are liable.[8] The liability does not extend to their *successors* in office.[9] The defendant in such a proceeding is entitled to prove that the enterprise of the contemplated company was abandoned before its formation; that no papers were filed; that he surrendered his stock, and notified the acting president that he would have nothing to do with it, and that in fact he had no further connection with it.[10] Where a judgment was recovered on a four months' draft of the corporation, dated November 3, 1877, and the corporation failed to file the report required by the statute in the following January, it was held that the judgment creditor could maintain an action to enforce the liability of the pres-

[1] Nimmons *v.* Hennion, 2 Sweeny (N. Y.), 663.

[2] Sanborn *v.* Lefferts, 58 N. Y. 179.

[3] Easterly *v.* Barber, 65 N. Y. 252.

[4] Cameron *v.* Seaman, 69 N. Y. 396; *s. c.* 25 Am. Rep. 212.

[5] Easterly *v.* Barber, 65 N. Y. 252.

[6] Adams *v.* Mills, 60 N. Y. 533.

[7] Jones *v.* Barlow, 62 N. Y. 202.

[8] Boughton *v.* Otis, 29 Barb. (N. Y.) 196.

[9] Shaler &c. *v.* Bliss Co., 34 Barb. (N. Y.) 309; *s. c.* affirmed, 27 N. Y. 297.

[10] DeWitt *v.* Hastings, 69 N. Y. 518.

ident.[1] The directors are not exonerated by filing a report on the twenty-eighth day of the preceding December, the statute requiring it to be filed within twenty days from the first day of January.[2] It is not enough that the report be *made out* and ready to file within twenty days from the first of January; it must be *actually filed* within that time, and the time when it was made out and got ready to be filed is immaterial, so that it contains a truthful statement of the facts required by the statute, as of that date.[3] Where money was loaned to the corporation in 1873, for the recovery of which a cause of action accrued in 1874 in consequence of the failure of the directors to file the statutory report in that year, and there was another default in 1875, and the action was commenced under the statute in March, 1877, it was held not a good objection that the cause of action accrued in 1874, when made for the first time after the trial had taken place.[4] On the trial of such an action, the defense that the omission to file the report was in consequence of the *advice of the plaintiff*, given on the ground that the filing of the report would hurt the credit of the corporation, which was at the time largely indebted, should be submitted to the jury.[5] The *statute of limitations* runs in favor of the trustees from the time of each particular failure, and a subsequent failure, or a successive number of subsequent failures, does not operate to extend the time within which suit may be brought against them.[6] It seems that a trustee, whose term of office expired before the contracting of the debt, will not be liable, unless the plaintiff proves that he *held over;* and the fact of his holding over will *not be presumed.*[7]

[1] South Norwalk Bank *v.* Fenton, 23 Hun (N. Y.), 309.

[2] Cincinnati Cooperage Co. *v.* O'Keefe, 44 Hun (N. Y.), 64.

[3] Butler *v.* Smalley, 101 N. Y. 71.

[4] Duckworth *v.* Roach, 81 N. Y. 49. For a failure of the report of trustees of a manufacturing corporation to comply with both N. Y. Laws 1848, ch. 40, and 1853, ch. 333, the trustees become liable for all the debts of the company, as provided by section 12 of said chapter 40. Blake *v.* Wheeler, 18 Hun (N. Y.), 496.

[5] Carraher *v.* Mulligan, 28 N. Y. St. Rep. 439.

[6] Cornell *v.* Roach, 9 Abb. N. Cas. (N. Y.) 275; Losee *v.* Bullard, 79 N. Y. 404; distinguishing Boughton *v.* Otis, 21 N. Y. 261. See also Merchants' Bank *v.* Bliss, 35 N. Y. 412.

[7] Philadelphia &c. Co. *v.* Hotchkiss, 82 N. Y. 471. What corporations are within the provisions of this statute: Allen *v.* Clark, 49 N. Y. St. Rep. 175; *s. c.* 21 N. Y. Supp. 338. That the *publication in an obscure paper of limited circulation* does not comply with the statute, but renders the trustees liable: Whitney *v.* Cammann, 18 N. Y. Supp. 200. That the statute does not by implication pro-

§ 4234. Construction of Other Statutes. — By the provisions of the statute of *Massachusetts*[1] the directors of every corporation, forming an organization under that act, are required to make annually, in the month of January, a certificate containing a statement of certain facts and particulars, which is to be signed and sworn to by the president, treasurer, and a majority of the directors, and to deposit the same with the clerk of the town or city within which such corporation is located. By a subsequent statute, this provision was so far modified that such certificate, containing the required statements as to the condition of the corporation on the first day of the month then next ensuing, may be made at any time in each year. Construing this statute, it is held that if the directors make and deposit the proper certificate in any month during the year, they will perform the duty required of them, if they make a similar certificate at any time during the corresponding month in the next ensuing year; and they will be guilty of no neglect of duty in that respect by failing or omitting to make and deposit a new certificate until after the expiration of such corresponding month. If the certificate is made and deposited in any month during one year, the officers will be liable for any debts contracted after the expiration of the corresponding month of the year next ensuing, if they should not, within that time, have made and deposited a like certificate of a like kind; and they will continue to be so liable for debts contracted till the proper certificate is made and deposited by the directors. But they will not be liable for any debt contracted during, or till after the expiration of the whole of the next corresponding month.[2] Under such

hibit a *forfeiture of the charter:* People *v.* Buffalo Stone &c. Co., 131 N. Y. 140; *s. c.* 15 L. R. A. 240; 42 N. Y. St. Rep. 753; 29 N. E. Rep. 947. That the words "*each year*" in the amending Act of 1875, ch. 110, take the place of the word "*annually*" in the original Act of 1848, chapter 40, § 12, and leave the statute of the same import: Allen *v.* Clark, 49 N. Y. St. Rep. 175; *s. c.* 21 N. Y. Supp. 338.

[1] Mass. Stat. 1851, ch. 133, § 9.

[2] Bond *v.* Clark, 6 Allen (Mass.), 361. Another statute of that State requires the filing with the secretary of the Commonwealth of semi-annual reports (Supp. to Gen. Stats., vol. I., p. 810, § 33), and of any increase (*Ibid.*, § 34), or reduction (*Ibid.*, § 35),

statutes a liability attaches to *de facto* directors as well as those who are such *de jure*,[1] in conformity with a rule already stated.[2] The acting officers of a corporation will not be allowed to avail themselves of any *informalities* which may have taken place at the *meeting* at which they were chosen, in order to escape the liability imposed by such a statute.[3] Whether a given corporation belongs to the class of corporations required to file such a report, must of course be determined by a reference to its charter or governing statute.[4] The annual statement required of directors by such a statute must be made without regard to whether there was or was not a *stockholders' meeting*.[5] The California statute[6] requiring the *posting of itemized accounts* and *balance-sheets* is construed as referring to two separate papers, either of which may be posted. The detailed statement mentioned in the statute is construed as applying only to the itemized account;[7] so that the apparent purpose of the statute may be conveniently evaded by filing a balance-sheet merely. A "*balance-sheet,*" according to the commercial understanding of the term, posted by the directors of a mining corporation, is sufficient, although it does not contain all the particulars mentioned in the first section.[8] In an action under this statute it must be alleged that money had in fact been received and liabilities incurred. An allegation that the directors *pretended* to have received large sums of money and incurred large liabilities is not sufficient.[9] The directors are liable for the *willful failure* of the superintendent to make the reports therein required, but not for his *negligence*

of capital stock, and annexes a penalty for failure. In the same State directors and trustees of banks, in winding them up, and receivers, are required to make annual financial reports, under a penalty of a forfeiture of twenty dollars for each day's neglect. Gen. Stats. Mass., p. 319, §§ 156, 157.

[1] Newcomb *v.* Reed, 12 Allen (Mass.), 362.

[2] *Ante*, § 3901.

[3] Thayer *v.* New England Lith. Steam Printing Co., 108 Mass. 523.

[4] Cooke *v.* Pearce, 23 S. C. 239.

[5] *Ibid.*

[6] Cal. Act of April 23, 1880; Cal. Acts of 1880, p. 134.

[7] Eyre *v.* Harmon, 92 Cal. 580; *s. c.* 28 Pac. Rep. 779.

[8] *Ibid.*

[9] Hewlett *v.* Epstein, 63 Cal. 184.

in failing to make them.[1] The statute does not render the directors liable for *each failure* to post the verified balance sheet therein required.[2] Where it appeared in evidence, in an action under the statute, that a director and stockholder, when elected superintendent, served as such, though declaring that he would not, and managed the business of taking out ores and working them, it was held that a finding that the corporaton *worked its mines* was justified.[3] The mere fact that the directors have not the information sufficient to enable them to post the itemized account or balance-sheet required by the statute, is no defense to such an action, unless they make it appear that they *could not obtain* the necessary information.[4] Where a right of action accrues to a stockholder by reason of the failure of the directors to post the itemized account at the time required by the statute, it is not avoided by posting it at a subsequent time, although before an action is actually commenced.[5]

§ 4235. Filing a False Report not Equivalent to Filing No Report. — Where the proceeding is instituted under a statute making directors liable for failure to file a stated report, the allegations of the complainant are not made good by proving that they filed a report which was *false.* The reason is, that the statute, being *penal,* must be strictly pursued, and that if the creditor would charge the directors with filing a false report, he must frame his complaint under the branch of the statute which makes them liable in case the report which they file is false, and he must allege in substance that the signers of it did so, *knowing* its statements to be false and with a fraudulent intent.[6] In like manner, the penalty im-

[1] Eyre *v.* Harmon, *supra.*

[2] Loveland *v.* Gârner, 71 Cal. 541.

[3] Beal *v.* Osborne, 72 Cal. 305; *s. c.* 13 Pac. Rep. 871.

[4] Schenck *v.* Bandmann, 81 Cal. 231; *s. c.* 22 Pac. Rep. 654.

[5] *Ibid.* A director of a corporation organized for mining purposes is not relieved from the making and posting of an itemized balance-sheet imposed by the California *Act of March 30, 1874,* upon directors of all corporations formed for that purpose, by the fact that it has not engaged in mining. Francais *v.* Somps, 92 Cal. 503; *s. c.* 28 Pac. Rep. 592.

[6] Mathews *v.* Patterson, 16 Col. 215; *s. c.* 26 Pac. Rep. 812.

posed by the New York Manufacturing Act of 1848, does not attach where a report is made and filed in external form, complying with the statute, although some of its material representations may be untrue. In other words, a false report cannot be regarded as no report, but must be dealt with under another provision of the statute.[1]

§ **4236. Publication of Articles of Incorporation under Iowa Statute.** — The statute law of Iowa requires a *publication of the articles of incorporation* before a newly organized corporation is entitled to do business, and makes the *stockholders* liable for the debts of the corporation if such publication is not made. This statute and the interpretation it has received have been the subject of several adjudications by the supreme court of that State which are dealt with in a former title.[2]

ARTICLE VI. LIABILITY FOR MAKING FALSE REPORTS.

SECTION
4240. Introductory.
4241. Nature of these statutes.
4242. Such statutes penal: strictly pursued — whether enforceable in other States.
4243. Only those liable who sign the report.
4244. *Scienter:* doctrine that the report must have been willfully false.
4245. Such willfulness a question of fact for a jury.
4246. What facts sufficient to make out a case.
4247. What reports have passed judicial scrutiny.
4248. Defense that the report was voluntary, and not such as required by the statute.
4249. Each report gives a separate cause of action.
4250. Statements of such a report.
4251. Whether directors so liable for antecedent debts.
4252. Liability to the creditors collectively under Massachusetts statute.
4253. Director is an "officer."
4254. No defense that the director is also a creditor.
4255. Questions of procedure.

§ **4240. Introductory.** — The statutes which have been considered in the previous article, enjoining upon the directors

[1] Bonnell *v.* Griswold, 80 N. Y. 128.

[2] *Ante*, § 2977; First Nat. Bank *v.* Davies, 43 Iowa, 424; Eisfeld *v.* Kenworth, 50 Iowa, 389; Marshall *v.* Harris, 55 Iowa, 182; *s. c.* 7 N. W. Rep. 509; Heuer *v.* Carmichael, 82 Iowa, 288; *s. c.* 47 N. W. Rep. 1034; 9 Rail. & Corp. L. J. 274.

and officers of corporations the making of certain reports, would afford little security to the public, if they were not followed up by statutes imposing a personal liability upon them in case such reports are *false*. Such statutes exist in most of the States, and we are now to deal briefly with them. They are threefold: 1. Those imposing a *criminal liability* as for *perjury*.[1] 2. Those making the guilty directors *jointly and severally liable* for the debts of the corporation.[2] 3. Those making them liable *in damages* to any person injured.[3] To

[1] Such as: Comp. Laws Mich. 1871, § 3002; Ga. Code 1873, § 1474; Gen. Stats. Ky. 1879, p. 329, § 3 (liable to the penalties for *false swearing*). By the following they are guilty of a *misdemeanor:* Cal. Penal Code, § 564; Battle's Rev. Stats. N. C., p. 263, § 15, Bright. Purd. Dig. Pa. 1873, p. 349, § 172; Comp. Laws Utah 1876, p. 635, § 325. See also Comp. Laws Mich. 1871, § 2932; *Ibid.*, § 2954; Rev. Stats. N. Y. (Banks & Bros., 6th ed., 1876), vol. II., p. 310, § 84 (relating to safety fund banks); Rev. Stats. Maine 1871, p. 424, § 8; Minn. Stats. at Large, p. 487, § 29; Gen. Laws Oregon 1872, p. 419, § 587; Rev. Stats. Wis. 1878, § 4435. Several of the statutes either enact *civil remedies* in the same sections, or provide in express terms that civil remedies shall not be affected: Comp. Laws Mich. 1871, § 2932; *Ibid.*, § 2954; Minn. Stats. at Large, p. 487, § 29; Bright. Purd. Dig. Pa. 1873, p. 349, §§ 174, 175.

[2] Such as: Rev. Stats. N. Y. (Banks & Bros., 6th ed., 1876), vol. II., p. 794, § 21. For similar forms see *Ibid.*, p. 709, § 15; *Ibid.*, p. 761, § 15; *Ibid.*, p. 763, § 79; *Ibid.*, p. 727, § 37; *Ibid.*, p. 507, § 50; *Ibid.*, p. 620, § 12 (gas-light companies); Cod. Stats. Mont. 1871–72, p. 409, § 18; Rev. Stats. N. J. 1877, p. 187; Rev. Stats. Texas 1879, p. 597, art. 4134; Tenn. Acts 1875, pp. 247, 254, 260; Col. Gen. Laws 1877, § 215. A statute of North Carolina makes them "individually liable *as sureties* for the company to such directors," etc.: Battle's Rev. Stats. N. C., p. 263, § 15; Minn. Stats. at Large, p. 487, § 29; Comp. Laws Mich. 1871, § 2954; *Ibid.*, § 2932. Some of the statutes add the words "*knowing it to be false*": 2 Bright. Purd. Dig. Pa. 1873, p. 1410, § 34; Gen. Stats. R. I. 1872, p. 306, § 18; Rev. Stats. S. C. 1873, p. 362, § 34. So also Rev. Stats. Mass. 1836, ch. 38, § 17. Another has added: "*Knowing it to be so or without due inquiry.*" Gen. Stats. N. H. 1867, p. 282, § 14.

[3] Such as: Hurd's Rev. Stats. Ill. 1880, p. 281, § 21; Col. Gen. Laws 1877, § 209. Similarly, Cal. Act Apr. 1, 1876, § 3; 1 Cal. Civil Code 1876, § 316; 1 Hittell's Codes & Stats. 1876, § 5316; Civil Code Dak. Ter., § 409; Gen. Stats. Neb. 1873, p. 201, § 140. Other statutes giving damages for fraudulently inducing persons to give credit to the corporation: Comp. Laws Ariz. 1877, § 3139; Gen. Laws Oregon 1872, p. 527, § 15. See also 1 Thomp. & Steg. Tenn. Stat. 1871, § 1489 (imposing penalties). A statute of Michigan relating to insurance companies makes the offending officers "severally liable to a penalty of $500 each": Comp. Laws Mich. 1871, § 2311; and by a statute of Nebraska there is a fine of $500 and an action

the last-named class may be added statutes making them liable for damages caused by the publication of false reports, prospectuses, etc., *voluntarily put forth.*

§ **4241. Nature of These Statutes.** — Statutes of this kind are believed to be either declaratory of the common law, or else enacted with the design of affording better remedies to creditors than those afforded by the common law, as expounded by a class of weak and discreditable decisions,[1] which have denied a remedy to the party defrauded in such cases, on the ground of *want of privity* with the directors, or because the representations were not addressed directly to the party defrauded by them, — thus remanding him for his damages to the security of a supposed corporate fund, when no such fund existed. In the view of the Court of Appeals of Maryland, a judgment obtained, under the New York statute,[2] *against a director* for signing a false report, *merges* whatever right of action the creditor may have against the same person *as a stockholder;*[3] but two judges dissented,[4] and the case was reversed on a Federal question.[5] Aside from this, the view seems quite untenable that the liability thus created should affect the liability of the same person as a stockholder, whether arising by statute or otherwise, saving, of course, that he could not be required to pay the same debt to the corporation *twice.* Such an offense would not fall within the common-law definition of perjury, because that consists in willfully swearing falsely to some material fact in issue in a *judicial proceeding.*[6] But the common-law offense is believed to be supplemented, in the criminal codes of most of the States, by statutes making it a misdemeanor willfully to make a voluntary and corrupt oath.[7] Such statutes would,

for damages: Gen. Stats. Neb. 1873, p. 201, § 140.

[1] See and compare *ante,* §§ 1471, 1472, 1500, 4144, 4145.

[2] N. Y. Laws 1875, ch. 611, § 21.

[3] Attrill *v.* Huntington, 70 Md. 191; *s. c.* 14 Am. St. Rep. 344; 16 Atl. Rep. 651.

[4] Stone and McSherry, JJ.

[5] Huntington *v.* Attrill, 146 U. S. 657; *ante,* § 4166.

[6] 2 Bish. New Crim. Law, § 1015.

[7] See State *v.* Boland, 12 Mo. App. 74.

of course, reach and punish the offense of willfully swearing falsely to such reports and statements as those under consideration. The making and swearing to such a report, knowing it to be false, is also *perjury* under a general statute providing that, if any person, of whom an oath shall be required by law, shall willfully swear falsely, in regard to any matter or thing respecting which such oath is required, such person shall be deemed guilty of perjury.[1] If such a report is sworn to, not in positive terms, but if the affiant simply states that the statements made in it are, "according to the *best of his knowledge and belief*, true," and yet he knows them to be false, he is equally guilty of perjury as though he had sworn in positive terms that they were true. But in order to convict of perjury in such a case, it must appear clearly that the false oath was taken with some degree of deliberation, and that it was not owing to mere weakness, or that it was not the result of surprise or inadvertency; and although the books of the corporation have been mutilated to correspond with the return, yet if, discarding the books entirely, the return is substantially true, the defendant cannot be convicted.[2]

§ 4242. Such Statutes Penal: Strictly Pursued — Whether Enforceable in Other States.—Statutes of this kind fall within the class which have been generally regarded as *penal*,[3] and which the State courts have generally refused to enforce when enacted by the Legislature of *another State*.[4] But the Supreme Court of the United States has, in a recent decision, which is believed to be both sound and beneficial,[5] taken a step toward a conclusive settlement of this question, by holding that the refusal of the courts of one State to give

[1] Rev. Stats. Mass., ch. 128, § 2.

[2] Com. *v.* Dunham, Thach. Cr. Cas. (Mass.) 519.

[3] Whitaker *v.* Masterton, 106 N. Y. 277.

[4] *Ante*, § 4166. Compare *ante*, § 3052.

[5] It is to be hoped that the doctrine of this case, in so far as it holds that conflicts of this kind between the different States present *Federal questions*, will be extended so as to find a Federal question in the refusal of the courts of a State to give due faith and credit to the acts of judicial assignees, trustees, and receivers appointed in other States.

effect, within their limits, to a judgment recovered in another State against the directors of a corporation, for a debt of the corporation, for which they are made liable by reason of filing a false report under a statute of the kind under consideration, is a refusal to *give full faith and credit* to the judicial proceedings of another State, as required by the constitution of the United States.[1] A statute of the kind under consideration has, however, been held to be a penal statute, in such a sense that the right of action given by it does not *survive* to the personal representatives of a creditor of the corporation.[2] It is also subject to the rule which applies to penal statutes, that, in order to a recovery under them, they must be *strictly pursued;* so that the state of facts upon which the statute gives the penalty must be clearly alleged and proved,—from which it follows that where a report is filed which is *false*, the creditor cannot recover his debt of the directors, proceeding under another section of the statute, which makes them liable for the debts of the corporation in case of their *failure* to file the prescribed report: the filing of a *false* report not being tantamount to the filing of *no* report, thus mixing and confusing the two statutes.[3] Where the statute requires the filing of a certificate or statement by a corporation, as, for instance, the filing of a certificate of the amount of capital stock paid in,[4] and the object of the statute is not to afford information to the public, but merely to enable the corporation to procure its right to transact business and to save its agents from a penalty, the falsity of the certificate will not constitute such fraud or deceit as will sustain an action by a person who has purchased shares of stock in the corporation in reliance upon it, after having obtained information of its contents through a search by his attorney.[5] But this decision is believed to be

[1] Huntington *v.* Attrill, 146 U. S. 657; reversing *s. c. sub. nom.* Attrill *v.* Huntington, 70 Md. 191; *s. c.* 14 Am. St. Rep. 344; 16 Atl. Rep. 651; 2 L. R. A. 779.

[2] Boyke *v.* Thurber, 50 Hun (N. Y), 259; *s. c.* 19 N. Y. St. Rep. 881.

[3] *Ante*, § 4235; Matthews *v.* Patterson, 16 Col. 215; *s. c.* 26 Pac. Rep. 812.

[4] Mass. Stats. 1884, ch. 330, § 3.

[5] Hunnewell *v.* Duxbury, 154 Mass. 286; *s. c.* 28 N. E. Rep. 267. Effect of the Pa. Act of April 29, 1874,

unsound, because the directors or officers filing the false certificate must know that the public are liable to be misled by it, and ought to be held to indemnify the public against the natural consequences of their own fraud and deceit. The court proceed upon the analogy of decisions,[1] to the effect that, in order to hold a person liable for the consequences of his misrepresentations on the ground of deceit, the misrepresentations must have been intended to influence the mind of the plaintiff.[2]

§ 4243. Only Those Liable Who Sign the Report.—There is no doubt that, under such statutes, there is no vicarious liability, or liability by representation, but that only those directors or officers are liable who signed the false report.[3]

§ 4244. Scienter: Doctrine that the Report must have been Willfully False.—The weight of opinion is that statutes making directors and other officers of corporations jointly and severally liable for the corporate debts, for making and publishing false reports or statements of the condition of the company, being *penal* in their nature and hence to be strictly construed,[4] do not impose such a liability unless the reports or statements were *willfully false*,[5]—which fact must be *alleged* or the complaint will be demurrable.[6] Such a conclusion was easy under the statute of Massachusetts,[7] which contained the clause "knowing it to be false"; there was not much difficulty in holding that, in order to charge the directors, it was necessary to show, not only that the certificate made and signed by

in repealing the penal provisions of the Act of July 18, 1863, making directors liable for false reports: Barber *v.* Standard Sewer Pipe Co., 5 Pa. County Ct. 293.

[1] Such as Fogg *v.* Pew, 10 Gray (Mass.), 409; *s. c.* 71 Am. Dec. 662.

[2] But compare *ante*, §§ 1471, 1472, 1500, 4144, 4145, 4241.

[3] Pier *v.* Hanmore, 86 N. Y. 95; Pier *v.* George, 86 N. Y. 613.

[4] *Ante*, §§ 4164, 4242.

[5] Stebbins *v.* Edmands, 12 Gray (Mass.), 203; Felker *v.* Standard Yarn Co., 148 Mass. 226; *s. c.* 22 N. E. Rep. 896; Pier *v.* Hanmore, 86 N. Y. 95; Pier *v.* George, 86 N. Y. 613; Bonnell *v.* Griswold, 89 N. Y. 122.

[6] Matthews *v.* Patterson, 16 Col. 215; *s. c.* 26 Pac. Rep. 812.

[7] R. S. Mass. 1836, ch. 38, §§ 17, 28. For the present statute of that State, see Mass. Pub. Stat., ch. 106, § 60.

them as directors was false, but that they knew it to be false. It was not enough to prove that the certificate did contain the exact truth according to the strict interpretation of the statute. It must be made to appear that it was willfully false — made intentionally with the purpose of deceiving. The *scienter*, or guilty knowledge intended by the statute, must be equivalent to *mala fides* in making the certificate. This conclusion resulted, not only from the statute itself, but also from the fact that it was penal, and, therefore, to be strictly construed. But it was conceded that in many cases it would be competent to infer bad faith and guilty knowledge from the fact that the statements or representations contained in the certificate were false.[1] But it is more difficult to conclude, under the New York statute, which omits these words, that in order to sustain such an action against the directors, *bad faith* or a *fraudulent purpose* must be shown, as the penalty follows an actual, not a constructive, falsehood;[2] and that some fact or circumstance must be shown indicating that it was made in bad faith or for some fraudulent purpose, and not innocently or inadvertently.[3] Notwithstanding the interpretation put upon that statute by the highest court of that State, it is easier to conclude, having reference to the purpose of the statute of protecting the public from giving credit to insolvent corporations, that, as the statute imposes upon the directors the *duty of knowing*, and as they have the means and opportunity of knowing, negligent ignorance has the same effect in charging them with liability as actual knowledge. Some courts, construing that statute, have accordingly taken the view that ignorance, innocence,[4] or absence of an intent to defraud,[5] will be no defense; and hence a director signing a false report cannot set up that he

[1] Stebbins *v.* Edmands, 12 Gray (Mass.), 203. So, under the present statute: Felker *v.* Standard Yarn Co., 148 Mass. 226; *s. c.* 22 N. E. Rep. 896.

[2] Bonnell *v.* Griswold, 89 N. Y. 122.

[3] Pier *v.* Hanmore, 86 N. Y. 95; Pier *v.* George, 86 N. Y. 613.

[4] Brand *v.* Godwin, 29 N. Y. St. Rep. 143.

[5] Torbett *v.* Eaton, 49 Hun (N. Y.), 209; *s. c.* 17 N. Y. St. Rep. 117; 1 N. Y. Supp. 614; Chittenden *v.* Thannhauser, 47 Fed. Rep. 410; *s. c.* 10 Rail. & Corp. L. J. 442.

signed it in good faith, under the *advice of counsel*, believing it to be true.[1] Under this theory, it is not necessary that the director should know that the report is false, but it is his duty to know that it is true; and the fact that the report is untrue in any material representation is sufficient to charge him.[2]

§ 4245. Such Willfulness a Question of Fact for a Jury. Nor is the solution of this question of interpretation helped one way or the other by taking into consideration the further proposition that the question whether such willfullness existed is, in an action at law, a question of fact for a jury.[3] The question is, what interpretation is to be put upon the statute; not what branch of the judicial machinery is to decide the facts. It is for the judge to interpret the statute,[4] and, in a trial by jury, to tell the jury what it means; and unless there is evidence which, if believed by the jury, would fairly warrant the conclusion of willfulness or bad faith, it will be error for him to submit the question to them at all.

§ 4246. What Facts Sufficient to Make out a Case.—Let us next consider some cases answering the inquiry what facts are sufficient to make out a case under such a statute, or rather what state of evidence is sufficient to take the question to a jury. Where the statute enacted that the officers should be liable if the certificate was false in any material representation, and the certificate set forth that the capital stock had been paid in in *cash*, whereas in fact it had been paid in in *property* of an uncertain value, it was held that this was a material misrepresentation, and the officers were liable.[5] Where the certificate stated that the capital stock, of $2,000,-000, had been paid up in full, and it appeared that the whole

[1] Brand *v.* Godwin, 3 N. Y. Supp. 807; *s. c.* 8 N. Y. Supp. 339.

[2] Huntington *v.* Attrill, 118 N. Y. 365; *s. c.* 23 N. E. Rep. 544; 29 N. Y. St. Rep. 5; affirming *s. c.* 42 Hun (N. Y.), 459.

[3] Pier *v.* Hanmore, 86 N. Y. 95; Pier *v.* George, 86 N. Y. 613; Brockway *v.* Ireland, 61 How. Pr. (N. Y.) 372.

[4] Thomp. Trials, § 1050, *et seq.*

[5] Waters *v.* Quimby, 27 N. J. L. 198.

of the stock had been issued to A. in payment for certain mining property, the value of which was *speculative*, but which did not exceed $70,000, of which fact the trustee had notice, it was held that the action was maintainable against him.[1] In another case it appeared that A. had purchased land for $80,000, paying therefor $8,000 in cash, and giving a purchase-money mortgage for the residue; that the next year he conveyed the land to a corporation, of which he had in the mean time been elected director, receiving in payment its entire stock, amounting to $700,000; that he and H. subsequently subscribed and swore to a certificate of full-paid stock, stating that the amount of capital paid in full was the sum of $700,000; it was held that a verdict for the plaintiff was supported by the evidence.[2] So, where the certificate contained the names of two persons as stockholders and stated the amount of their stock as actually paid in, when in fact they were not stockholders at all, this report was "false in a material representation," and the directors signing it were liable.[3]

§ 4247. What Reports have Passed Judicial Scrutiny. — Where the charter of a manufacturing corporation required a certificate within thirty days after the payment of the last installment of capital stock, it was held that a certificate, made within thirty days after the officers were satisfied and had decided that the capital was paid in, was sufficient.[4] So, where the statute required directors to make and file a report which should "state the amount of the capital and proportion actually paid in, and the amount of its existing debts," and a subsequent statute enacted that, in all reports of the company to be published, stock issued in payment of mines or other property should not be stated or reported as issued for cash paid into the company, but should be reported in this respect according to the fact, and the report in question stated:— "The amount of the capital stock of this company, and which

[1] Blake *v.* Griswold, 103 N. Y. 429.

[2] Huntington *v.* Attrill, 42 Hun (N. Y.), 459; *s. c.* affirmed, 118 N. Y. 365.

[3] Brand *v.* Godwin, 8 N. Y. Supp. 339; *s. c.* 29 N. Y. St. Rep. 143.

[4] Waters *v.* Quimby, 27 N. J. L. 296.

has been issued for the purchase of patent rights, and which has not been paid in cash, is $300,000; amount of existing debts, $45,393.88";—in the absence of express proof of an intention to evade the statute and put forth a false and deceptive report, this was held a substantial compliance with its requirements; although the language was admitted to be ambiguous and to be susceptible of a construction that a portion of the company's capital had been paid in cash.[1]

§ 4248. Defense that the Report was Voluntary, and not Such as Required by the Statute. — A statute of New Jersey requires certain officers and directors of certain corporations, within thirty days after the payment of the last installment of the capital stock, to make, file, and publish a certificate stating the amount of the capital so fixed and paid in in cash.[2] Another section requires the same thing to be done in case of any increase of the capital stock.[3] Another makes such officers and directors, in case of a failure to perform this duty, or if the certificate shall be untrue, jointly and severally liable for all the debts of the company contracted after the expiration of the said thirty days and before such certificate shall be recorded as aforesaid.[4] Further on there is a section reading as follows: "If any certificate made or any public notice given by the officers of any company, in pursuance of the provisions of this act, shall be false in any material representation, all the officers who shall have signed the same shall be jointly and severally liable for all the debts of the company contracted while they were stockholders thereof."[5] Suppose the directors make, file, and

[1] Whitney Arms Co. *v.* Barlow, 63 N. Y. 62; *s. c.* 20 Am. Rep. 504. To a similar effect in a case where the complaint was framed with a count under the statute for *failing* to file a report, and also with a count under the statute for filing a *false* report,—see Whitaker *v.* Masterton, 106 N. Y. 277; 12 N. E. Rep. 604. That a *slight discrepancy* as to the amount of capital stock paid in, and an *erroneous statement* that a certain person was a stockholder will not render the officers personally liable,—see Walton *v.* Godwin, 33 N. Y. St. Rep. 886; 11 N. Y. Supp. 391.

[2] Nix. N. J. Stats. 458, § 19.

[3] *Ibid.*, § 20.

[4] *Ibid.*, § 21.

[5] *Ibid.*, § 30.

publish the certificate required by the first of these sections *before* the capital stock is paid in, and thereafter, and before the capital stock is paid in, a debt is contracted, will they be personally liable to pay such debt? This question was seriously raised and discussed at length. It was indeed admitted that the certificate was false; but it was contended nevertheless that the defendants were not liable for making it, because it was not such a certificate as is required by the section of the statute first quoted. That section required a certificate to be made within thirty days after the last installment of capital stock should be paid in; but the certificate in question was made before that time. Therefore, it was contended that it was not such a certificate as the statute called for, and there was no personal liability upon the defendants for making it, although it was false. It was plain to see that this contention, if allowed, would operate entirely to defeat the statute; for it would result in this: if the last installment of stock was not paid in, the certificate was not required by the act, and was hence not within the penalty of the statute, although false; while, if the last installment was paid in, then the defendants were not liable because it would not be false. It is almost needless to say that the court did not take this view of it, although one judge dissented.[1]

§ 4249. Each Report Gives a Separate Cause of Action.— The filing of a false report by a manufacturing corporation on successive years gives rise to a separate cause of action as to each year, under the New York statute of 1848.[2]

§ 4250. Statements of Such a Report.—In the annual statement of the assets of the corporation required by the

[1] Waters *v.* Quimby, 27 N. J. L. 296. It was also held that the penalty given by the nineteenth section was prospective, while that given by the thirtieth section was retrospective; the former making the directors liable for debts contracted after their default in filing and publishing the certificate required, and the latter making them liable for the payment of debts accruing before the making of the false certificate.

[2] Anderson *v.* Speers, 58 How Pr. (N. Y.) 68.

Iowa statute, it is improper to state the outstanding accounts as assets, without deducting an approximate amount for probable losses.[1] Profits of a former season should not be stated as a separate item, where they have not been declared or withdrawn from the general assets.[2] It was at one time held in the Supreme Court of New York that, under the Statute of 1848 of that State, relating to manufacturing companies, the directors making such a report would be liable as for making a false report, unless their report stated how much of the capital stock had been paid for in cash and how much in property;[3] but a later holding of the Court of Appeals of that State is to the effect that it is not necessary for the report so to state, but that it is sufficient if it states the amount of the capital, that it has all been paid in, and then gives the amount of the existing debts.[4]

§ 4251. Whether Directors so Liable for Antecedent Debts. — It has been recently held in the Supreme Court of New York that the Statute of 1875 of that State[5] does not make the directors who have signed a false report liable for debts contracted before the publication of the report, especially where such debts matured before the date of such publication.[6] This decision keeps in view the policy of the statute, which is to make directors, who have published false reports which may have misled the public into giving a false credit to the company, liable for debts which may have resulted from the false credit thus created. But the Supreme Judicial Court of Massachusetts holds that the statute of that State,[7] providing that the officers of a corporation, who knowingly make a false certificate to be filed in the office of the secretary of the Commonwealth, "shall be jointly and severally liable *for its debts*,"

[1] Hubbard *v.* Weare, 79 Iowa, 678; *s. c.* 44 N. W. Rep. 915.

[2] *Ibid.*

[3] Pier *v.* George, 20 Hun (N. Y.), 210.

[4] Whitaker *v.* Masterton, 106 N. Y. 277; *s. c.* 12 N. E. Rep. 604; 8 N. Y. St. Rep. 888.

[5] N. Y. Laws 1875, ch. 611, § 21.

[6] Torbet *v.* Godwin, 62 Hun (N. Y.), 407; *s. c.* 42 N. Y. St. Rep. 323; 27 Abb. N. Cas. (N. Y.) 444; 17 N. Y. Supp. 46.

[7] Pub. Stats. Mass., ch. 106, § 60.

applies as well to debts existing when the certificate is made as to future debts.[1]

§ 4252. Liability to the Creditors Collectively under Massachusetts Statute.—Under the Massachusetts statute[2] the liability is to all the creditors as a class, and not to any particular creditor who may conclude to sue.[3]

§ 4253. Director is an "Officer."—A director is an officer within the meaning of the New York Statute of 1875, relating to limited liability companies, which makes officers who sign false reports liable for the debts of the corporation,[4] especially where, in case the directors were not deemed officers, the corporation would have but *one officer* who could sign the report, namely, its president.[5]

§ 4254. No Defense that the Director is Also a Creditor.—The fact that the director is a creditor of the company to an amount exceeding his stock furnishes no defense whatever to this species of liability.[6]

§ 4255. Questions of Procedure.—Some of the statutes provide for the simultaneous prosecution of actions against the offending officers and against the company.[7] One of them adds a provision for a *discovery*, with the qualification that the answer is not to be admissible against the person "charged with any of the said misdemeanors."[8] In an action under such a statute it is necessary to allege that the defendant *knew* the report to be false;[9] but it is not necessary to *plead*

[1] Felker *v.* Standard Yarn Co., 148 Mass. 226; *s. c.* 19 N. E. Rep. 220.

[2] Pub. Stats. Mass., ch. 106, § 60.

[3] George Woods Co. *v.* Storer, 144 Mass. 399; *s. c.* 11 N. E. Rep. 662.

[4] Brand *v.* Godwin, 3 N. Y. Supp. 807.

[5] Torbett *v.* Eaton, 49 Hun (N. Y.), 209; *s. c.* 17 N. Y. St. Rep. 117; 1 N. Y. Supp. 614.

[6] Richards *v.* Crocker, 19 Abb. N. Cas. (N. Y.) 73; *s. c.* 9 N. Y. St. Rep. 531.

[7] Gen. Stats. R. I. 1872, p. 306, § 19; Rev. Stats. S. C. 1873, p. 362, § 35.

[8] Bright. Purd. Dig. Pa. 1873, p. 349, § 176.

[9] *Ante*, § 4244; Matthews *v.* Patterson, 16 Col. 215.

the evidence from which such knowledge is to be inferred.[1] In an action to render directors of a corporation personally liable for signing a false certificate that the capital stock was fully paid in, the *report of commissioners* appointed to take subscriptions to stock, stating that a certain per cent in cash had been paid in, has been held competent *evidence* where it was not shown that the amount stated has not been paid in.[2] In an action under the New York Statute of 1875,[3] a *judgment* recovered by the plaintiff against the corporation is *not* admissible in *evidence* to establish the *debt*.[4]

ARTICLE VII. LIABILITY FOR DEBTS CONTRACTED IN EXCESS OF A PRESCRIBED LIMIT.

SECTION
4259. Introductory.
4260. The making of such excessive loans a misdemeanor.
4261. Differences among the statutes as to limit of indebtedness.
4262. Loans to the directors themselves.
4263. Individual liability imposed upon what directors.
4264. Extent of the liability imposed.
4265. To whom liable: to creditors—to the corporation itself.
4266. Provisions for the exoneration of dissenting directors.
4267. Whether the corporation also liable for such excessive debts.
4268. Remedies given to enforce these statutes.
4269. Liability both for excessive debts and for deficits occasioned by insolvency.
4270. No defense that the corporation did not get the benefit.

SECTION
4271. No recovery unless on a case strictly within the statute.
4272. No defense that a receiver has been appointed, etc.
4273. No defense that procedings have not been taken to dissolve corporation.
4274. No defense that another action is pending against defendants as stockholders.
4275. Such statutes not enforceable in other States.
4276. Renewals, substitutions, and application of part payments.
4277. This liability extends to debts due to stockholders.
4278. Right of action not altered by corporate dissolution.
4279. What contracts are "debts" within the meaning of such statutes.
4280. Statute of limitations.

[1] Taylor *v.* Thompson, 66 How. Pr. (N. Y.) 102.

[2] Hatch *v.* Attrill, 118 N. Y. 383; *s. c.* 23 N. E. Rep. 549; 29 N. Y. St. Rep. 14.

[3] Laws N. Y. 1875, ch. 611, § 21.

[4] Torbett *v.* Goodwin, 17 N. Y. Supp. 46; Watson *v.* Goodwin, 17 N. Y. Supp. 51; following Miller *v.* White, 50 N. Y. 137. Compare *ante*, § 3396, *et seq.*; *post*, § 4329.

§ **4259. Introductory.** — Among the devices adopted by legislation to secure to the shareholders in business corporations an exemption from liability to pay the debts of the company, and at the same time to protect the public dealing with such companies, is that of prohibiting the directors from contracting debts in behalf of the corporation beyond a stated limit, and making them personally liable for any such excess, or imposing other penalties upon them. Perhaps the simplest form of such a statute, which can be quoted as an example of the others, is the following from the statutes of New York, of which there are several chapters relating to different kinds of business corporations: "If the indebtedness of any such corporation shall at any time exceed the amount of its capital stock, the directors of such corporation creating such indebtedness shall be personally and individually liable for such excess to the creditors of such corporation."[1] Another form, from the same statutes, is slightly different in respect of the words printed in Italics: "If the indebtedness of any such company shall at any time exceed the amount of the capital stock, the trustees of such company *assenting thereto* shall be personally and individually liable for such excess to the creditors of such company."[2] A little attention to this statute will suggest that it leaves widely open several doors for judicial construction. First, what is the meaning of the expression "capital stock"? Does it mean simply the *subscribed stock*, or the stock *subscribed by solvent persons*, or the stock subscribed and actually *paid in?* And does it include or exclude stock subscribed and paid for in specific property? Secondly, what will be the evidence of the assent of a particular director? Will his assent be *presumed* from the fact that he was a member of the administration at the time when the prohibited debt was created? Or must his assent be affirmatively proved by the creditor proceeding against him? Thirdly, is he liable for such excess to any creditor whose

[1] Rev. Stats. N. Y. (Banks & Bros., 6th ed., 1876), vol. II., p. 794, § 22.

[2] *Ibid.*, p. 710, § 23. Similarly, see *Ibid.*, p. 508, § 58.

debt was created after the limit had been reached, or is his liability to all the creditors as a class, so that the action against him must be brought by or on behalf of all? Fourthly, the debt being prohibited by positive law, does it remain enforceable against the corporation in the absence of a saving clause to that effect in the statute? Other questions which have arisen under such statutes will be suggested by succeeding sections of this article; but the solution of some of them is rendered simple by the canon of interpretation that these statutes are *penal* and hence to be *strictly construed.*[1]

§ 4260. The Making of Such Excessive Loans a Misdemeanor. — Statutes of some of the States also punish the making of such excessive loans as a *misdemeanor.*[2]

§ 4261. Differences among the Statutes as to Limit of Indebtedness.—On further analyzing these statutes, wide differences will be discovered among them in respect of the amount of the indebtedness which the directors are allowed to contract. The most usual limit is the amount of the capital stock actually paid in.[3] But statutes are found fixing it at "fifty per cent of the amount of its capital actually paid in."[4] Others fix it loosely at "the amount of its capital stock,"[5] without saying whether this means merely potential stock, subscribed stock, stock actually paid in, or stock paid in property as well as money. Another fixes the limit at "the solvent stock of such company,"[6]—implying that the stock need not be paid in, but that it must be subscribed by solvent persons.

[1] *Ante,* §§ 4164, 4242.

[2] Such as: Cal. Penal Code, § 566. See also Rev. Stats. N. Y. (Banks & Bros., 6th ed., 1876), p. 545, § 77; Comp. Laws Utah 1876, p. 635, § 327.

[3] Rev. Laws Idaho, p. 622, § 14; Rev. Code Md. 1878, p. 376, art. 7; Comp. Laws Nev. 1873, § 3402; Bright. Purd. Dig. Pa. 1873, 1080, § 25; Gen. Stats. R. I. 1872, p. 306, § 14; Rev. Stats. S. C. 1873, p. 339, § 9; Tenn. Acts 1875, p. 248.

[4] Ala. Code 1876, § 1902.

[5] Hurd Rev. Stats. Ill. 1880, p. 280, § 16; Rev. Code Miss. 1871, § 2420; Cod. Stats. Mont. 1871, p. 409, § 25; Rev. Stats. N. Y. (Banks & Bros., 6th ed., 1876), vol. II., p. 794, § 22; *Ibid.,* p. 710, § 23; *Ibid.,* p. 508, § 58; Laws Wyo. 1869, p. 241, § 22.

[6] Ind. Stats. 1876, p. 662, § 25. See Aimen *v.* Hardin, 60 Ind. 119.

Another fixes it at the subscribed capital stock;[1] and this is applicable to all the subscribed capital stock, irrespective of the mode of disposition, and whether it is paid in or not.[2] Another fixes the amount at "twice the amount of its capital stock paid in, exclusive of deposits."[3] Another fixes it at "*one-half* its capital stock then actually *paid in or unimpaired.*"[4] Another is more explicit, thus: "The total amount of the debts which any incorporated company shall at any time owe, whether for deposits or by bond, bill, note, or other contract, over and above the actual deposits with the said company, shall not at any time exceed three times the amount of the capital stock actually paid in."[5] Another, in the same State, enacts: "No debt or debts shall be contracted or incurred by or on behalf of any incorporated railroad company, beyond or exceeding its available means in its possession under its control and belonging to it, including its *bona fide* and available stock subscriptions, and exclusive of its real estate, at the time the same shall be contracted or incurred, to pay and discharge the same and all its debts previously contracted or incurred."[6] Another, in the same State, drops simply and vaguely to "one-half the amount of its capital stock";[7] and to offset this, another in Pennsylvania rises to "three times the amount of its capital actually paid in."[8] Another, in the same State, fixes a low and vague limit at "three-fourths of the actual available assets of such company."[9] Some statutory draughtsmen have thought it necessary to exclude the idea that the indebtedness referred to should not include the capital stock itself, which book-keeping has set down on the debit side,—as by reciting that "the total amounts of the debts and liabilities

[1] Cal. Civ. Code, § 309.

[2] Moore *v.* Lent, 81 Cal. 502; *s. c.* 22 Pac. Rep. 875.

[3] Gen. Stats. Mass., p. 203, §§ 25, 26.

[4] Gen. Stats. N. H. 1867, p. 281, § 4. Railroad directors, authorized by N. H. Laws 1871, ch. 83, to contract debts for construction and equipment, are not liable under this statute for debts so contracted, though exceeding half the capital stock and assets. Niagara Bridge Works *v.* Jose, 59 N. H. 81.

[5] Rev. Stats. N. Y. (Banks & Bros., 6th ed., 1876), vol. II., p. 399, § 3.

[6] *Ibid.*, p. 545, § 77.

[7] *Ibid.*, p. 446, § 36.

[8] Bright. Purd. Dig. Pa. 1873, p. 997, § 288.

[9] *Ibid.*, p. 1410, § 33.

(other than its capital stock) of any such company shall never exceed the amount of its capital stock actually paid in."[1] A statute of Rhode Island limits the indebtedness which banking companies can create to "*sixty-five per cent* of its capital stock actually paid into said bank."[2] From this the limit mounts upward in a statute of South Carolina to "double the amount of its capital stock actually paid in,"[3] and again sinks in Vermont to "two-thirds of the capital stock of such corporation actually paid in."[4] By the codes of California and Dakota the directors of corporations are prohibited from creating debts "beyond their subscribed capital stock."[5] A statute of Iowa,[6] provides that articles of incorporation must fix the highest amount of indebtedness to which the corporation is to be at any time subject, which must, in no case, except in that of insurance companies, exceed two-thirds of the capital stock; and another section [7] provides that a failure to comply substantially with this and other requisites in relation to organization and publicity renders the stockholders individually liable for the debts of the corporation. This statute is held to mean *potential* or *authorized stock*, and not stock actually subscribed for at the time when the articles are filed.[8] Under a provision of the National Currency Act, the directors of *national banks* who make or assent to the making of a loan to any one person, of a sum exceeding one-tenth of the capital stock of the bank, become personally and individually liable for all loss sustained thereby.[9]

[1] Bright. Purd. Dig. Pa. 1873, p. 1080, § 25.

[2] Gen. Stats. R. I. 1872, p. 296, § 22.

[3] Rev. Stats. S. C. 1873, p. 362, § 33.

[4] Gen. Stats. Vt. 1862 (Appendix 1870), p. 550, § 43. See National Bank *v.* Paige, 53 Vt. 452.

[5] 1 Cal. Civ. Code, § 309; Civ. Code Dak. Ter., § 409.

[6] Iowa Code 1880, § 1061.

[7] *Ibid.*, § 1068.

[8] Sweny *v.* Talcott, 85 Iowa, 103; *s. c.* 52 N. W. Rep. 106.

[9] Rev. Stats. U. S., § 5200; Witters *v.* Sowles, 31 Fed. Rep. 1; *s. c.* 24 Blatchf. (U. S.) 332. Provisions specially applicable to educational and religious corporations: Rev. Stats. N. Y. (Banks & Bros., 6th ed., 1876), vol. II., p. 400, § 11; Comp. Laws Kan. 1879, § 1176; Rev. Stats. Texas 1879, p. 106, art. 635.

§ **4262. Loans to the Directors Themselves.** — As a corporation may lawfully make a contract with one of its directors,[1] loans of money by the corporation to the directors *are to be counted* in determining whether the limit prescribed by the statute has been reached prior to the making of the particular loan with which it is sought to charge the directors.[2] The National Currency Act provides that "the total liabilities to any association, of any person, or of any company, corporation, or firm, for money borrowed, including, in the liabilities of a company or firm, the liabilities of the several members thereof, shall at no time exceed one-tenth part of the amount of the capital stock of such association actually paid in."[3] By another section of the same statute "if the directors of any national banking association shall knowingly violate, or knowingly permit any of the officers, agents, or servants of the association to violate, any of the provisions of this title, ... every director who participated in or assented to the same shall be held liable in his personal and individual capacity for all damages which the association, its shareholders, or any other person, shall have sustained in consequence of such violation."[4] Under these statutes there is a holding, which seems entirely untenable if not unintelligible, that the statute does not apply as against a director where a loan is made to himself, though it does apply as against his co-directors assenting to the loan. The theory of the case is, that the director who procured the loan for himself stands liable as a simple debtor.[5] But this interpretation cannot possibly be sound, because a director violates his duty in assisting in the making of a loan to himself where the statutory limit has been passed, even more than in making it to a third person, and the theory which remits him to the position of a simple debtor destroys that part of the statute[6] which makes him liable to the "shareholders or any

[1] *Ante*, § 4059.

[2] Thacher *v.* King, 156 **Mass. 490;** *s. c.* 31 N. E. Rep. 648.

[3] Rev. Stats. U. S., § 5200.

[4] *Ibid.*, § 5239.

[5] Witters *v.* Sowles, 31 Fed. Rep. 1; *s. c.* 24 Blatchf. (U. S.), 332.

[6] Rev. Stats. U. S., § 5239.

other person," sustaining injury in consequence of such violation. On the other hand, the director violating the statute by receiving the prohibited loan cannot, if he is otherwise a creditor of the corporation, have the remedy against the directors provided for by the statute, because that would give him a remedy for his own wrong.[1] So, under a statute of New Hampshire,[2] providing that no stockholder who consented to the creation of a corporate debt in excess of the statutory limit "shall recover against any corporation who did not . . . . consent thereto," a stockholder to whom the corporation became immediately and originally indebted in excess of the statutory limit, cannot recover against stockholders who did not consent to the creation of the indebtedness.[3]

§ 4263. Individual Liability Imposed upon What Directors. A further analysis of these statutes will show a considerable difference among them as to the designation of the directors upon whom this individual liability is imposed. By the language of one of them, "if such debts and liabilities at any time exceed such amount, the directors, *who were such at the time* such excess of debt was created, are jointly and severally liable for such excess, unless it is shown that they voted against the contracting of such debt or liability."[4] By another, "trustees, under whose administration this provision is violated, are jointly and severally liable to the corporation or creditors for the excess."[5] By another, "every officer, agent, or stockholder of any railroad company who knowingly assents to or has any agency in contracting any debt by or on behalf of such company, unauthorized," etc., "is guilty of a misdemeanor."[6] By others, the liability is imposed upon "the directors and officers of such corporation *assenting thereto*."[7] By another, "the directors . . . . shall be liable

[1] Thacher *v.* King, 156 Mass. 490; *s. c.* 31 N. E. Rep. 648; *ante*, § 4186.

[2] Gen. Laws N. H., ch. 149, § 15.

[3] Connecticut River Bank *v.* Fiske, 62 N. H. 178.

[4] Ala. Code 1876, § 1902.

[5] Rev. Laws Idaho, p. 622, § 14, condensed.

[6] Cal. Penal Code, § 566.

[7] Hurd Rev. Stats. Ill. 1880, p. 280, § 16; Cod. Stats. Mont. 1871, p. 409, § 25; Rev. Stats. N. Y. (Banks &

in their individual property for any debt they may contract over and above the solvent stock of the company."[1] By others, the liability is imposed upon the directors "under whose administration it happens."[2] By another, the liability is imposed upon "the directors who contracted such debts";[3] by another, "the directors of such corporation creating such indebtedness";[4] in another, "the directors under whose administration the same may have happened, except those who may have caused their dissent therefrom to be entered at large on the minutes of the said directors at the time, and except those who were not present when the same did happen."[5] By another, "every officer, agent, or stockholder of said company, who shall knowingly assent to, or have any agency in contracting or incurring any debt in violation of the provisions of this section, shall be personally and individually liable to pay such debt."[6] By another, "the directors and officers contracting the same, or assenting thereto."[7] By another, "the directors for the time being shall forfeit $1,000 each."[8] By another, "if they do contract debts for a larger amount, they shall be individually liable for the same after the means of the corporation are exhausted."[9]

§ 4264. Extent of the Liability Imposed.—Nearly all the statutes make the directors, upon whom the liability is imposed, liable for the excess of debts contracted beyond the prescribed limit.[10] Most of the statutes use such language as "shall be

Bros., 6th ed., 1876), vol. II., p. 710, § 23; *Ibid.*, p. 508, § 58; *Ibid.*, p. 446, § 36; Tenn. Acts 1875, p. 248; Gen. Stats. Vt. 1862 (Appendix 1870), p. 550, § 43; Laws Wyo. 1869, p. 241, § 22.

[1] Ind. Stat. 1876, p. 622, § 25.

[2] Rev. Stats. Me. 1871, p. 410, § 40. Similarly, Rev. Code Md. 1878, p. 376, art. 7; Gen. Stats. Mass., p. 203, § 27; Comp. Laws Nev. 1873, § 3402; Bright. Purd. Dig. Pa. 1873, p. 440, § 33; Gen. Stats. R. I. 1872, p. 306, § 14; *Ibid.*, p. 276, § 22; Rev. Stats. S. C. 1873, p. 339, § 9; *Ibid.*, p. 362, § 33.

[3] Rev. Code Miss. 1871, § 2420.

[4] Rev. Stats. N. Y. (Banks & Bros., 6th ed., 1876), vol. II., p. 794, § 22.

[5] *Ibid.*, p. 399, § 3.

[6] *Ibid.*, p. 545, § 77.

[7] Bright. Purd. Dig. Pa. 1873, p. 997, § 288; *Ibid.*, p. 1080, § 25.

[8] Gen. Stats. R. I. 1872, p. 296, § 25.

[9] Rev. Stats. Tex. 1879, p. 106, art. 635.

[10] Hurd's Rev. Stats. 1880, p. 280, § 16; Rev. Stats. Me. 1871, p. 410, § 40; Gen. Stats. Mass., p. 203, § 27;

liable for such excess"; but some of them vary the language by saying in form that the directors who assent to the contracting of debts beyond the prescribed limit "shall be liable *for the same*";[1] or liable for any debt they may contract over and above the prescribed limit.[2] Some of them make their liability in terms analogous to that of guarantors, by adding some such expression as "after the means of the corporation are exhausted."[3] Some statutes say: "And in case of any excess, the directors, under whose administration it shall happen, shall be jointly and severally liable, to the extent of such excess, for all the debts of the company then existing, and for all that shall be contracted, as long as they shall respectively continue in office, and until the debts shall be reduced to the amount of the capital stock of such company paid in."[4] Another statute enacts that "the directors for the time being *shall forfeit $1,000* each, and the *charter* of such bank shall thereupon be *declared null and void*."[5] It has been held, under a New York statute, which makes directors jointly and severally liable to the corporation, in case the indebtedness shall exceed three times the amount of the capital stock actually paid in, and to the creditors thereof in the event of a dissolution of the corporation,—that the liability of the directors is not restricted to those debts which were contracted or remained unpaid while the excess of indebtedness existed, but attaches to *any debt* of the corporation, in case it shall appear, upon investigation, that *at any time* there has been an

Rev. Code Miss. 1871, § 2420; Cod. Stats. Mont. 1871, p. 409, § 25; Comp. Laws Nev. 1873, § 3402; Rev. Stats. N. Y. (Banks & Bros., 6th ed., 1876), vol. II., p. 399, § 3; *Ibid.*, p. 794, § 22; *Ibid.*, p. 710, § 23; *Ibid.*, p. 508, § 58; *Ibid.*, p. 545, § 77; *Ibid.*, p. 446, § 36; 2 Bright. Purd. Dig. Pa. 1873, p. 997, § 288; *Ibid.*, p. 1410, § 33; *Ibid.*, p. 1080, § 25; Gen. Stats. R. I. 1872, p. 296, § 22; Rev. Stats. S. C. 1873, p. 339, § 9; Rev. Stats. S. C., p. 362, § 33; Tenn. Acts 1875, p. 248; Gen. Stats. Vt. 1862 (Appendix 1870), p. 550, § 43; Laws Wyo. 1869, p. 241, § 22.

[1] Rev. Code Md. 1878, p. 376, art. 7; Rev. Stats. Tex. 1877, p. 106, art. 635.

[2] Ind. Stats. 1876, p. 662, § 25.

[3] Comp. Laws Kan. 1879, § 1176; Rev. Stats. Tex. 1877, p. 106, art. 635.

[4] Gen. Stats. R. I. 1872, p. 306, § 14. So nearly, Bright. Purd. Dig. Pa. 1873, p. 1410, § 33; Rev. Stats. S. C. 1873, p. 362, § 33.

[5] Gen. Stats. R. I. 1872, p. 296, § 25.

excess of indebtedness beyond the limit fixed by the statute.[1] This view of such statutes seems to be unsound. It ignores the real policy of the statute, which is the protection of the creditors of the corporation, and makes it more highly penal than necessary to accomplish its purposes. A better view is that taken by the same court at a later date, that the personal liability created by the statute should be limited to *debts* due to creditors to whom such excess is owing.[2] It is, by the terms of most of the statutes themselves, and by their manifest policy, *limited to the amount of the excess* of the debts over the prescribed limit.[3] Where a *single creditor* is permitted to sue, he cannot recover the entire excess *in solido*, but at most can recover only the amount of *his* debt or demand;[4] and under some theories he can only recover his proportion of it.[5] On the other hand, where the liability was, as it is described in the simplest forms of these statutes, "for the excess," an interpretation has been fallen into which assimilates their liability to that of *guarantors of final payment*, which is believed to comport best with the real policy of all such statutes, by holding that the effect of the statute is to make the directors individually liable for such specific debts only as were contracted with their assent in excess of the paid-up capital, and which remained unpaid *after the exhaustion of the corporate assets.*[6] But where the charter of a bank provided that in case of an overissue of bills, the directors under whose administration it should happen should be liable for the same, in their private and individual capacities, and also that the stockholders should be ultimately liable for the redemption of all the bills issued, the *liability of the stockholders* for such excess was not secondary and collateral to that of the directors, so as to require their personal liability to be *first exhausted.*[7] In some

[1] Tallmadge *v.* Fishkill Iron Co., 4 Barb. (N. Y.) 382.

[2] Patterson *v.* Robinson, 37 Hun (N. Y.), 341.

[3] Sturges *v.* Burton, 8 Ohio St. 215; *s. c.* 72 Am. Dec. 582.

[4] Moultrie *v.* Smiley, 16 Ga. 289.

[5] Anderson *v.* Spears, 21 Hun (N. Y.), 568; *s. c.* 59 How. Pr. (N. Y.) 421.

[6] Allison *v.* Coal Co., 87 Tenn. 60; *s. c.* 9 S. W. Rep. 226; 4 Rail. & Corp. L. J. 559.

[7] McDougald *v.* Lane, 18 Ga. 444.

cases the draughtsmen of such statutes have thought it necessary to negative, in express terms, the conclusion that a debt for which the directors are rendered so liable includes the indebtedness of the corporation for its capital stock; but, in the absence of such clauses, a judicial decision would hardly be necessary to establish that the indebtedness referred to in such statutes does not include the theoretical indebtedness of the corporation to its own stockholders for their stock.[1]

§ 4265. To Whom Liable: To Creditors — to the Corporation Itself. — Most of these statutes simply make the directors contracting such excessive debts, liable therefor to the creditors of the company,[2] meaning, of course, to the persons in whose favor such debts were contracted. In some cases it is not distinctly so expressed;[3] but in such cases the implication of course is, that they are liable to creditors; because when it is said that a man is liable for a debt, the meaning is that he is liable to the person to whom the debt is due. Some of the statutes have declared a liability to the corporation as well as to its creditors. Thus, a statute of South Carolina uses this language: "And in case of excess the directors in whose administration it shall happen shall be jointly and severally liable for the same in their natural capacities, as well to the directors of the other party as to the corporation."[4] So, a statute of New York uses this language: "Shall in their individual and private capacities, jointly and severally, be liable for such excess to the said corporation, and in the event of its dissolution, to any of the creditors thereof, to the full

[1] The debts referred to in Cal. Civ Code, § 309, making directors of corporations personally liable for debts, created beyond their subscribed capital stock, do not include capital stock paid for corporate property: Moore *v.* Lent, 81 Cal. 502; *s. c.* 22 Pac. Rep. 875.

[2] Cod. Stats. Mont. 1871, p. 409, § 25; Rev. Stats. N. Y. (Banks & Bros., 6th ed., 1876), vol. II., p. 794, § 22; *Ibid.*, p. 710, § 23; *Ibid.*, p. 508, § 58; *Ibid.*, p. 545, § 77; *Ibid.*, p. 446, § 36; Gen. Stats. R. I. 1872, p. 296, § 22; Tenn. Acts 1875, p. 248; Laws Wyo. 1869, p. 241, § 22.

[3] Bright. Purd. Dig. Pa. 1873, p. 997, § 288; *Ibid.*, p. 1410, § 33; *Ibid.*, p. 1080, § 25; Gen. Stats. Vt. 1862 (Appendix 1870), p. 550, § 43; Ind. Stats. 1876, p. 662, § 25; Comp. Laws Kan. 1879, § 1176; Rev. Stats. Texas 1879, p. 106, art. 635.

[4] Rev. Stats. S. C. 1873, p. 339, § 9.

amount of such excess, with legal interest from the time such liability accrued."[1] The author does not recall any case where the effect of this clause making them liable to the corporation has been construed. The corporation presumptively gets the consideration of the debt contracted, although in excess of the statutory limit. Does the statute mean that the corporation can keep this benefit, and then, after having paid the debt (or possibly without having paid it), turn round and sue the directors and recover it of them? It is very difficult to see how any liability can attach for such an act, save to the creditor of the corporation in whose favor the debt was contracted. Even where the corporation becomes insolvent, its assignee or receiver, in suing to enforce such a liability of the directors, would act in right of the creditors, and not in right of the corporation; for the latter, having suffered a practical dissolution, would have only a theoretical right at most in seeing that its just debts were paid. Where, however, the liability is to the corporation itself, and the action to enforce it is brought against the directors by the corporation or its legal representative, the directors are entitled to a *reduction for advances* made by them to the company, as well against the demand of creditors after dissolution, as they would have against the demand of the corporation before dissolution.[2] Where such a statute says that they shall be liable to creditors, does it mean that they shall be liable to any creditor who may elect to sue, or to all the creditors as a class? Where the statute prescribes a remedy in equity,[3] there would not be much difficulty in answering the question; because, by the principles of that forum, such an action would ordinarily be brought by or on behalf of all the creditors against all the directors liable. And this construction has been put upon a statute of New York relating to manufacturing corporations,[4] —the conclusion being that such action can only be brought

[1] Rev. Stats. N. Y. (Banks & Bros., 6th ed., 1876), p. 399, § 3. Nearly the same is Comp. Laws Nev. 1873, § 3402. See Tallmadge *v.* Fishkill Iron Co., 4 Barb. (N. Y.) 382.

[2] Tallmadge *v.* Fishkill Iron Co., 4 Barb. (N. Y.) 382.

[3] *Post*, § 4310, *et seq.*

[4] N. Y. Laws of 1848, ch. 40, § 23.

by *all the creditors jointly*, or by one in behalf of himself and all the others, and that each creditor can only recover such a *proportion* of the excess of the debts over the amount of the capital stock as his debt bears to the whole amount of the debts of the company.[1]

§ 4266. Provisions for the Exoneration of Dissenting Directors. — It is assumed, on grounds elsewhere discussed,[2] that any director may exonerate himself from the liability thus imposed, by showing that he dissented from the creation of the prohibited debt, and did what he could to prevent it. But as this opens the door to frauds on the statute, some of the Legislatures have seen fit to prescribe in express language what shall be evidence of such dissent sufficient to exonerate the director. Thus, a statute of New York contains this exception: "Except those who may have caused their dissent therefrom to be entered at large on the minutes of the said directors at the time, and except those who were not present when the same did happen."[3] An exception in nearly the same words is found in a statute of Nevada,[4] and, it is believed, in other statutes. Some of the statutes are more explicit, — providing that *absent* or *dissenting* directors may be exonerated by recording their vote on the minutes, or giving notice at a stockholders' meeting;[5] or by giving notice of such absence or dissent to either of the bank commissioners;[6] or to the governor and council, and to the stockholders at any general meeting;[7] or by filing a written objection with the secretary of the company or with the clerk of the county.[8] There is hardly a doubt that these statutes are exclusive, and that no other mode of exoneration is open to the director. But in the case of the more numerous class of statutes, where the lia-

[1] Anderson *v.* Speers, 21 Hun (N. Y.), 568; *s. c.* 59 How. Pr. (N. Y.) 421.

[2] *Ante*, § 4111; *post*, §§ 4358, 4359, 4360, 4361.

[3] Rev. Stats. N. Y. (Banks & Bros., 6th ed., 1876), vol. II., p. 399, § 3.

[4] Comp. Laws Nev. 1873, § 3402.

[5] 2 Bright. Purd. Dig. Pa. 1873, p. 1410, § 33; Rev. Stats. S. C. 1873, p. 339, § 9; *Ibid.*, p. 362, § 33.

[6] Gen. Stats. Mass., p. 203, § 28.

[7] Rev. Stats. Me. 1871, p. 410, § 41. Nearly the same is Rev Code Md. 1878, p. 376, art. 7.

[8] 2 Stant. Ky. Stat., p. 521, § 16.

bility is imposed upon "the *directors assenting thereto*," the creditor would, in order to recover, on elementary principles, be required to state and prove a case within the statute; and this would require him both to allege and prove that the directors against whom he proceeds did assent to the unlawful contract. Moreover, if the statute exempts from liability those directors who were not present when the debt was contracted, it is necessary, in order to charge a director, to show affirmatively that he was present when this was done.[1] But where the statute, like some of the above, points out the mode which the director must pursue for his exoneration, a mere *simulated compliance* with it will not exonerate him. When, therefore, a director, in formal compliance with such a statute,[2] recorded, in the proper county court office, a notice that the indebtedness of the company exceeded the capital stock by $268, and stated his objection thereto, but nevertheless continued to officiate actively as a director, and co-operated in carrying on and expanding the company's business, till the excess of indebtedness over the capital stock was swelled to more than $5,000, and he filed no further notice and objection under the statute, and did not prove that he did not concur in and approve the contracting of such increased indebtedness, it was presumed that they were contracted, either at his instance, or with his sanction, and he was held liable.[3] In one State only, so far as the writer knows, has this statutory liability been held to attach to all the directors without reference to their assent or dissent; and the case so holding is so clearly out of line with all other American decisions on the point, that it must be regarded as not well decided.[4]

§ 4267. Whether the Corporation also Liable for Such Excessive Debts. — Under judicial conceptions which prevailed fifty years ago, when the so-called doctrine of *ultra vires* was much more *fashionable* than now, if a corporation were by statute prohibited from contracting a debt in excess

1 Irvine *v.* McKeon, 23 Cal. 472.

2 2 Stant. Ky. Stat., p. 521, § 16.

3 Cornwall *v.* Eastham, 2 Bush (Ky.), 561.

4 Banks *v.* Darden, 18 Ga. 318.

of a certain amount, any debt so contracted would be held *void*, so that no recovery could be had thereon against the corporation.[1] But it is believed that such judicial conceptions are seldom acted upon at the present day.[2] There are decisive reasons against it. First, the general public who deal with corporations cannot, from the nature of things, have the means of knowing the volume of the indebtedness of any business corporation; but the stockholders have the right to inspect the corporate books, and legal remedies, some of them highly penal, exist to compel the exercise of this right.[3] They, therefore, have the means of knowing the volume of the corporate debts, and what their trustees, the directors, are doing in the execution of their trust. Secondly, in the absence of fraud or collusion, such a contract is always executed on the side of the lender. He has parted with his money and the corporation has received it. The contract has been fully *executed on one side*, — which brings the case within the rule, hereafter considered, which prevents a corporation from setting up the defense of *ultra vires* to avoid contracts made for it by its duly appointed officers.[4] Thirdly, this case is strongly analogous to the case where a natural person or corporation appoints an agent to perform a certain duty and gives him orders *how* to perform it. If the agent, while acting in the discharge of that employment, injures a third person, the principal is liable, although the agent may have acted against his express orders.[5] So, here, the State clothes the corporation with the general power of contracting debts, but prohibits the directors from exercising this power beyond a certain limit. In the case of the agent the stranger cannot in general know whether he has acted in conformity with his instructions or against them. So in the case of the directors contracting the debt, the obligee can

[1] *Post*, § 5968, *et seq.*

[2] See, however, Workingmen's Banking Co. *v.* Rautenberg, 103 Ill. 460; *s. c.* 42 Am. Rep. 26; Weber *v.* Spokane Nat. Bank, 50 Fed. Rep. 735.

[3] *Post*, § 4407, *et seq.*

[4] *Post*, § 6024.

[5] *Post*, § 6283. Compare the reasoning in Underhill *v.* Santa Barbara &c. Co., 93 Cal. 300, 310; *s. c.* 28 Pac. Rep. 1049.

never know whether the prescribed limit of indebtedness has been reached. The principle which holds the principal in the one case, will hold the corporation in the other. Not only legal analogies, then, but the strongest considerations of justice, require that the corporation should hold to such contracts, unless the creditor at the time of giving the credit *knows* that the statutory limit of indebtedness has been reached;[1] and, in the absence of decisions to the contrary, this may safely be accepted as the view of the courts and of the profession. But some of the Legislatures have thought it necessary to put this question beyond peradventure by express enactments. "This provision," says the Legislature of Maine, "shall not exempt the bank, or its lands, goods, or chattels from liability for such excess."[2] "This shall not be construed," say the Legislatures of Rhode Island and Maryland, "to exempt the corporation, or their lands, tenements, goods, or chattels, from being also liable for and chargeable with such excess."[3] "But the debts," says the Legislature of New York, "contracted in violation of the provisions of this section, shall not be deemed invalid against the said company by reason thereof."[4] "The last section," says the Legislature of Utah, "does not affect the validity of a debt created in violation of its provisions, as against the company."[5] The enacting of these clauses cannot have been necessary; for it can scarcely be conceived that the Legislature could have intended, in enacting statutes making the directors liable for contracting debts beyond a prescribed limit, to impair the security of the creditor against the funds of the corporation on the faith of which he contracted, and remit him to an action against directors who may be personally insolvent. Accordingly, some of the courts have

[1] Underhill *v.* Santa Barbara &c. Co., *supra*. By the statute of Mississippi the directors are liable only provided the "creditor had no notice or knowledge of the excess of such contract, at the time it was made." Rev. Code Miss. 1871, § 2420.

[2] Rev. Stats. Me. 1871, p. 410, § 40.

[3] Gen. Stats. R. I. 1872, p. 296, § 23; Rev. Code Md. 1878, p. 376, art. 7.

[4] Rev. Stats. N. Y. (Banks & Bros., 6th ed., 1876), vol. II., p. 545, § 77.

[5] Comp. Laws Utah 1876, p. 635, § 328.

recently taken the view that unless the statute declares the contract void in express terms, it is to be construed, not as prohibiting the corporation from making it as between it and the creditor, but as making it a breach of trust on the part of the directors as between them and the corporation, and as giving the corporation or the creditors an additional remedy against the directors for any loss sustained by reason of it.[1]

§ **4268. Remedies Given to Enforce These Statutes.**— Some of the Legislatures have taken the precaution to prescribe the *remedies* which may be pursued to enforce the provisions of such statutes; and this should have been done in all cases, to avert the danger of the judges rendering the statutes ineffectual by narrow interpretations in respect of the remedies to be pursued under them. Some of the statutes prescribe an *action of contract;*[2] others an *action of debt;*[3] and it should be observed that this is the proper action at common law to recover the penalty given by such a statute.[4] Statutes enacted in States practicing under a *code*, where there is but one form of civil action, merely provide that the liability may be enforced *by an action.*[5] One of them makes the offending directors liable to *arrest* and *imprisonment* in execution of the judgment, in like manner as defendants in trespass.[6] Many of these statutes, and notably those just cited, provide for a survival of the cause of action, by stating that the action may be prosecuted against executors and administrators.

§ **4269. Liability Both for Excessive Debts and for Deficits Occasioned by Insolvency.**— Statutes have been enacted[7] which render directors liable for all excess of debts beyond a prescribed limit, without regard to the solvency of the corpora-

[1] Woolverton *v.* Taylor, 132 Ill. 197; *s. c.* 22 Am. St. Rep. 521; 23 N. E. Rep. 1007; 28 Am. & Eng. Corp. Cas. 467; Underhill *v.* Santa Barbara &c. Co., 93 Cal. 300, 307; *s. c.* 28 Pac. Rep. 1049.

[2] Gen. Stats. Mass., p. 203, § 27.

[3] 2 Bright. Purd. Dig. Pa. 1873, p. 1080, § 25.

[4] Sturges *v.* Burton, 8 Ohio St. 215; *s. c.* 72 Am. Dec. 582.

[5] Rev. Code Md. 1878, p. 376, art. 7.

[6] Rev. Stats. N. Y. (Banks & Bros., 6th ed., 1876), vol. II., p. 545, § 77.

[7] Such as Mich. Act, Mar. 15, 1837, § 25.

tion; and for all deficits in case of insolvency, without regard to the excess of debts incurred.[1]

§ **4270. No Defense that the Corporation did not Get the Benefit.** — Where the contract is fairly made on the part of the creditor, with the corporation through its agents, it is no defense that the corporation did not get the benefit of it; for to allow such a defense would be in effect to allow the directors, after having involved the corporation in liability for a prohibited loan, to escape the personal liability which the statute imposes upon them, on the ground that, in addition to this, they had cheated the corporation out of the proceeds. Thus, it was held no defense to an action, under an early Michigan statute, that the notes sued on came into the possession and control of a third person who, without the sanction of the bank, fraudulently used the same for his own purposes, and that the bank received no value for them. Such notes being payable to the bearer, it was wholly immaterial how they came into circulation, if they came into the possession of the plaintiff without any notice of fraud or unfairness; and this, without being alleged, will not be presumed.[2]

§ **4271. No Recovery unless on a Case Strictly within the Statute.** — It is a principle of legal procedure that when a party sues to enforce a liability created by a statute in derogation of the common law, he must not only distinctly aver, but he must make strict proof of, a case within the terms of the statute. The principle operates, if possible, more strongly where, as in the cases under consideration, the statute creates a liability in the nature of a penalty.[3] The principle is believed to be a rule of right rather than a rule of procedure, and hence applicable in the equitable, as well as in the legal, forum. Accordingly, it has been held that a bill in equity to enforce a liability of the kind under consideration, must clearly show that the excess of debts over and above the

[1] White *v.* How, 3 McLean (U. S.), 111.

[2] White *v.* How, 3 McLean (U. S.), 291. See *post*, § 5707.

[3] *Ante*, §§ 4164, 4242; *post*, § 4275.

amount of the capital stock actually paid in happened *under the administration of the defendants*,[1]— such being the language of the statute. So, under the Indiana statute, the plaintiff can only recover by showing that, at the time the debt was contracted, it was "over and above the solvent stock of such company."[2] So, where a statute made directors liable for suffering the corporate indebtedness at any one time to exceed the amount of capital stock paid in, and the evidence was that a quartz-mill and lode had been put in, worth from $6,000 to $8,000; that the defendant had put in $1,095; and that the debts amounted to $9,084,—it was held that a case was not made out to charge the director, since it did not appear that this was all the capital stock paid in, and such a fact was not to be presumed. Nor was the fact that the deed from the former owners of the mill and lode to the corporation, expressed a consideration of only $12, evidence that such was the value of the property, nor was that to be considered the amount paid in; for the real consideration of the deed of conveyance may always be inquired into, and the parties are not estopped by the deed from showing it.[3] In stating a case under the New York statute, it is enough to state the amount of the capital and of the claims which are outstanding, and it is not necessary that the debts making the statutory "excess" should be *due*. If an apparent claim is not real, the fact should be set up by answer.[4]

§ 4272. No Defense that Receiver has been Appointed, etc. Nor is it a good plea to such an action that a proceeding in chancery has been commenced with an injunction and the appointment of a receiver, and that, at the time of the appointment of the receiver, the notes sued on were the property of the bank; for this plea does not negative the plaintiff's right of property in the notes.[5]

§ 4273. No Defense that Proceedings have not been Taken to Dissolve Corporation.—In an action under section 5239 of

[1] Merchants' Bank *v.* Stevenson, 5 Allen (Mass.), 398.

[2] Aimen *v.* Hardin, 60 Ind. 119.

[3] Irvine *v.* McKeon, 23 Cal. 472.

[4] Robinson *v.* Attrill, 66 How. Pr. (N. Y.) 121.

[5] White *v.* How, 3 McLean (U. S.), 291.

the Revised Statutes of the United States, to charge a director of a national bank, under section 5200 of the same statutes, for making or assenting to an excessive loan, the fact that the comptroller has or has not procured a forfeiture of the charter of the bank, or attempted to procure the same, is irrelevant,[1] though one Federal judge held otherwise.[2]

§ 4274. No Defense that Another Action is Pending against Defendants as Stockholders.—It is no defense to a suit in equity,[3] to enforce this species of liability, that another suit in equity is pending, brought by the same plaintiffs against the same defendants, *as stockholders*, to enforce their personal liability, on the ground that the capital stock of the corporation was never paid in. And the same principle applies to the bill against the stockholders.[4]

§ 4275. Such Statutes not Enforceable in Other States.—The liability created by such statutes being in the nature of a *penalty*,[5] they are not enforceable outside the State enacting them,[6] unless the rule is to be regarded as changed by a more recent holding of the Supreme Court of the United States.[7]

§ 4276. Renewals, Substitutions, and Application of Part Payments.—It has been held that a giving of new notes for old ones is not an *increase* of indebtedness in such a sense as to render the directors liable, under such a statute, in an action based on the new notes, although the original indebtedness represented by them was in excess of the statutory limit.[8] Where there is an agreement between a corporation and its banker that the old indebtedness to the bank shall remain suspended, and that the proceeds of the commercial paper received from its customers and turned over to the bank

[1] Stephens *v.* Overstoltz, 43 Fed. Rep. 771.

[2] *Post*, § 4278.

[3] Under Mass. Stat. 1870, ch. 224, § 42.

[4] First Nat. Bank *v.* Hingham Man. Co., 127 Mass. 563.

[5] *Ante*, § 4164.

[6] First Nat. Bank *v.* Price, 33 Md. 487; *s. c.* 3 Am. Rep. 204.

[7] *Ante*, § 4166.

[8] National Bank *v.* Paige, 53 Vt. 452. Compare *post*, § 6060; *ante*, §§ 2018, 3117, 4196.

shall not be credited on the old indebtedness, but shall be applied to the payment of debts for supplies and other current expenses, the directors cannot be held liable, under such a statute, upon new paper made by it to the bank, upon which its commercial paper should have been applied under the agreement; for the effect of the agreement is to *pay* the new paper of the corporation, and it is hence no increase of indebtedness.[1] In short, the meaning of all these statutes is, whether they say so in direct terms or not, that the excess of corporate indebtedness which will render the directors personally liable must have existed *at one time*,[2] and that time must either have been the time of the creation of the particular debt upon which it is sought to charge the directors, or else that debt must have been created when the statutory limit was *full*.[3]

§ 4277. This Liability Extends to Debts Due to Stockholders. — Stockholders, as we have seen,[4] may in general make contracts with the corporation as strangers may, and are not conclusively charged with notice of the management of its internal affairs. There is nothing in the relation which subsists between a stockholder and the corporation of which he is a member, which precludes him, if he is a creditor of such corporation, from maintaining an action against the directors thereof under such a statute.[5] The circumstances may, however, be such as to preclude the stockholders from any remedy, on the theory of *acquiescence* in the creation of the excessive loan, — as where they voluntarily become stock-

[1] Patterson *v.* Robinson, 116 N. Y. 193; *s. c.* 26 N. Y. St. Rep. 685; 22 N. E. Rep. 372.

[2] Kritzer *v.* Woodson, 19 Mo. 327.

[3] Where a bank had allowed the liabilities of its directors to amount to a sum beyond that allowed by law, and the cashier of the bank, in anticipation of a legal examination of its affairs, and to reduce the liabilities of the directors, procured notes to be made and indorsed for his accommodation, and with them took up other notes of his, held by the bank, on which a director was an indorser, — it was held that the transaction was *not illegal*, and that the parties to the substituted paper were liable thereon. Seneca County Bank *v.* Neass, 5 Denio (N. Y.), 329.

[4] *Ante*, § 1071, *et seq.*; *post*, § 4460.

[5] Anderson *v.* Blattau, 43 Mo. 42 (overruling in effect Kritzer *v.* Woodson, 19 Mo. 327).

holders after the loan had been made and the mortgage placed upon the public records.[1] On the other hand, it is a sound interpretation of such statutes that an officer of a corporation who has paid a debt of the corporation, under a statute charging him with liability for the debts of the corporation because of official defaults or misprisions, has no remedy against the stockholders for *contribution*.[2]

§ **4278. Right of Action not Altered by Corporate Dissolution.** — It seems scarcely necessary to add that, although these statutes are said to be *penal*,[3] the right of action given by them does not abate with the expiration of the charter of the corporation.[4] So, under the National Banking Act,[5] the right of action against a director, to recover the damages sustained in consequence of an excessive loan, is not affected by the question whether the comptroller has or has not procured a forfeiture of the bank's charter.[6]

§ **4279. What Contracts are "Debts" within the Meaning of Such Statutes.** — Upon the question what corporate contracts create *debts*, or an *indebtedness*, within the meaning of prohibitory statutes of the kind under consideration, it has been held that a *mortgage* given by a bank to secure a depositor in the repayment of his deposits does not violate a statutory prohibition against increasing the indebtedness of the bank without the consent of the stockholders, so as to make the directors personally liable.[7] Similarly, it has been held that the execution of non-negotiable notes and mortgages by a corporation, the consideration of which is the promise of the mortgagees to advance money and deliver lumber as needed by the corporation to improve the mortgaged property, is not within the prohibition of the constitution of California, for-

[1] Walker *v.* Birchard, 82 Iowa, 388; *s. c.* 48 N. W. Rep. 71.

[2] Connecticut River Bank *v.* Fiske, 62 N. H. 178.

[3] Sturges *v.* Burton, 8 Ohio St. 215; *s. c.* 72 Am. Dec. 582.

[4] Moultrie *v.* Smiley, 16 Ga. 289.

[5] Rev. Stat. U. S., § 5239.

[6] Stephens *v.* Overstolz, 43 Fed. Rep. 771.

[7] Ahl *v.* Rhoads, 84 Pa. St. 319.

bidding an increase of the "bonded indebtedness" of a corporation without the sanction of a general law and the consent of a majority of the stockholders, so as to make the contract void.[1]

§ **4280. Statute of Limitations.** — In the application of *statutes of limitation* to the liability created by a statute which provides that "if the indebtedness of any stock corporation shall exceed the amount of its capital stock, the directors and officers of such corporation assenting thereto shall be personally and individually liable for such excess to the creditors of such corporation," — it has been held that the statute is not penal but *remedial*, and consequently that the period of limitation prescribed for penal actions does not attach.[2] Where, after having contracted an amount of indebtedness in excess of the limit prescribed by the statute, the directors contract a further indebtedness and execute promissory notes of the corporation therefor, the statute of limitations, in an action to charge them in respect of this further indebtedness under the statute, begins to run, not from the date of the execution, but from the date of the maturity of the notes.[3]

ARTICLE VIII. LIABILITY FOR CERTAIN PROHIBITED LOANS.

SECTION
4285. Loans to the stockholders prohibited.

SECTION
4286. Construction of these statutes.

§ **4285. Loans to the Stockholders Prohibited.** — The most numerous class of statutes which we shall consider in this article are directed against loans *to the stockholders* of the company, making the officers who assent thereto *jointly and severally liable therefor*.[4] Some of them are so drawn as to

[1] Underhill *v.* Santa Barbara Land &c. Co., 93 Cal. 300; *s. c.* 28 Pac. Rep. 1049. See also *post*, § 6060.

[2] Woolverton *v.* Taylor, 132 Ill. 197; *s. c.* 22 Am. St. Rep. 521; 23 N. E. Rep. 1007; 28 Am. & Eng. Corp. Cas. 647; reversing *s. c.* 30 Ill. App. 70.

[3] *Ibid.*

[4] 2 Bright. Purd. Dig. Pa. 1873, p. 1410, § 32; Rev. Stats. S. C. 1873,

meet a class of frauds which we have already had occasion to consider,[1]—that of allowing stockholders to make payment of their shares and then lending money back to them, the same being a mere *simulated payment.*[2] Others contain a saving clause permitting the payment of shares to be made in property other than money.[3] Some of the statutes denouncing loans to shareholders or members, contain exceptions in the case of *building* or *homestead associations*, or associations for the loan of money on real or personal property;[4] and others contain a similar exception in regard to *banks* generally.[5] Some of them impose limits upon the extent to which corporations may *guarantee or indorse.*[6] Some of them make it a *misdemeanor* to make or assent to the prohibited loan;[7] and some of them even make it *felony.*[8] Some of the statutes prohibit *loans* beyond a certain limit *to directors;*[9] others to directors, officers, and agents when the company is *insolvent;*[10] and many *special charters* contain similar provisions.[11] Some of them prohibit *savings banks* from lending money upon a *single name.*[12]

§ 4286. Construction of These Statutes.—Under these statutes, the directors stand answerable for the amount of the loan, with interest, to any creditor of the corporation until

p. 362, § 32; Rev. Code Md. 1878, p. 324, § 64; Rev. Code Miss. 1871, § 2417; Cod. Stats. Mont. 1871–72, p. 409, § 17; Rev. Stats. N. Y. (Banks & Bros., 6th ed., 1876), vol. II., p. 708, § 14; *Ibid.*, p. 793, § 20.

[1] *Ante*, § 1585.

[2] See, for example, Rev. Stats. N. Y. (Banks & Bros., 6th ed., 1876), vol. II., p. 507, § 49.

[3] Rev. Stats. N. Y. (Banks & Bros., 6th ed., 1876), vol. II., p. 761, § 14. Compare Rev. Stats. N. J. 1877, p. 186, § 54.

[4] Rev. Code Md. 1878, p. 324, § 64.

[5] Gen. Stats. N. H. 1867, p. 281, § 2.

[6] Rev. Stats. N. Y. (Banks & Bros., 6th ed., 1876), vol. II., p. 312, § 93.

[7] Rev. Stats. N. Y. (Banks & Bros., 6th ed., 1876), vol. II., p. 312, § 95; 2 Bright. Purd. Dig. Pa. 1873, p. 1079, § 23.

[8] Gen. Stats. Vt. 1862 (Appendix, 1870), p. 569, § 30; Cal. Acts 1877–78, ch. 481, § 8 (prohibiting investments in *mining stock*).

[9] Gen. Stats. N. H. 1867, p. 318, § 13.

[10] Rev. Stats. Mo. 1879, § 6024.

[11] See, for example, Conant *v.* Reed, 1 Ohio St. 298, where such a charter provision was under consideration.

[12] Conn. Gen. Stats., p. 519, § 38.

the loan is repaid. They are in fact made guarantors to all creditors of its repayment. The law treats them very much as though they had taken so much of the funds of the corporation out of its treasury and put it in their own pockets; and that is what such loans amount to in many cases. But it has been held that, to create a liability under such a statute, there must have been "a loan of money" both in fact and in law; that is, an actual loan of money in such a form as to create an indebtedness and a liability for repayment.[1] With regard to the validity of such a prohibited loan, some observations have already been offered with reference to another class of statutes which are equally applicable here. These statutes are enacted for the better security of creditors; and therefore in furtherance of the purpose of the statute, as well as on general principles, a loan should be held collectible, and any security given by it should be held good and enforceable. It has nevertheless been held that where a bank charter provides that no director shall be indebted to it above a certain amount, a note given to it by a director for an indebtedness in excess of that amount is void, and a guaranty thereof, although by one not a director, is not enforceable.[2] The decision seems strikingly unsound. It is as though a guardian, in violation of his duty, should make a loan of his ward's money to himself upon security of a note indorsed by a third person; and then, the guardian and his sureties becoming insolvent, the note should be held not collectible against the indorsers because the making of the loan for which it was given was prohibited by law. If the statute fixes the limit to the amount which may be loaned to directors and officers, it will be no defense to an action to charge the directors with violating it, to say that they *neglected* to keep themselves informed of the amount of the loans made to such officers.[3]

[1] Billings *v.* Trask, 30 Hun (N. Y), 314.

[2] Workingmen's Banking Company *v.* Rautenberg, 103 Ill. 460; *s. c.* 42 Am. Rep. 26.

[3] Bank Commissioners *v.* Bank of Buffalo, 6 Paige (N. Y.), 497. Compare *ante*, § 4262.

ARTICLE IX. LIABILITY FOR DECLARING UNLAWFUL DIVIDENDS.

SECTION
4288. Introductory.
4289. The general nature of these statutes.
4290. Statutes prescribing the cases in which dividends may and may not be declared.
4291. What is not a declaration of an illegal dividend under such statutes.
4292. Liable to the corporation.
4293. Remedies given by these statutes and procedure thereunder.
4294. Liable to creditor who is a stockholder.
4295. Liability under these statutes for dividends declared.

§ 4288. Introductory. — There is no form of statutory liability more commonly imposed upon directors of corporations in all the States of the Union, than that which makes them personally liable for declaring dividends, when there is no surplus to divide. Such a distribution of the assets of a corporation is in the nature of a fraud upon its creditors, and is *remediable in equity* on the same principle on which those courts aid judgment creditors in setting aside fraudulent conveyances.[1] It has been suggested that a director is liable *at common law* to the corporation or to a receiver of its assets, for willfully co-operating with other directors in declaring dividends when there are no surplus profits to divide.[2] But where there are profits which may lawfully be divided, whether a dividend shall be declared or not rests in general in the sound *discretion* of the directors,[3] subject to judicial supervision in the case of abuse.[4]

§ 4289. The General Nature of These Statutes. — The general nature of these statutes is that they prohibit the declaration and payment of dividends out of the capital stock, or where there is no surplus to divide, and make the

[1] Thomp. Stockh., § 19; Bank of St. Mary's *v.* St. John, 25 Ala. 566, 609; *ante*, § 2135.

[2] Van Dyck *v.* McQuade, 57 How. Pr. (N. Y.) 62; *s. c.* 45 N. Y. Super. Ct. 620; *s. c.* reversed on other grounds, 86 N. Y. 38.

[3] Ely *v.* Sprague, 1 Clarke (N. Y.), 351.

[4] *Ante*, § 2128. There is a note on the subject of the improper declaration of dividends in 19 Am. & Eng. Corp. Cas. 219.

directors assenting thereto jointly and severally liable in their individual capacities for all debts thereafter contracted, so long as they continue in office. They also contain provisions for exonerating dissenting directors, similar to those which have been already noticed in another connection. Without attempting to state in more detail the provisions of these statutes, or the points wherein they differ, some of them will be referred to in the marginal note.[1]

§ 4290. Statutes Prescribing the Cases in Which Dividends may and may not be Declared. — Nearly all the statutes under consideration in this article prescribe, in terms more or less definite, the circumstances under which dividends may or may not be declared. It will be found, on an analysis of these statutes, (1) that they permit the declaration of dividends at stated periods, or in the discretion of the directors, out of *profits*[2] or *surplus;* and (2) that they prohibit the declaration of dividends *out of the capital*[3] of the company, or (what is the same thing) except from surplus profits,[4] or net profits,[5] or net earnings;[6] or when the payment of the dividend would impair[7] or diminish[8] its capital; or while its

[1] 2 Bright. Purd. Dig. Pa. 1873, p. 996, § 20; Rev. Stats. Wis. 1878, § 1765; Rev. Stats. N. Y. (Banks & Bros., 6th ed., 1876), vol. II., p. 702, § 7 (mutual insurance companies); *Ibid.*, p. 398, § 2 (corporations generally); Rev. Stats. N. J. 1877, p. 178, § 7; Conn. Gen. Stats. 1875, p. 286, § 4; Rev. Stats. Mo. 1879, § 913 (savings banks and fund companies); Ga. Acts 1877, p. 35; Supp. Ga. Code, § 300 (corporations generally).

[2] Ga. Code 1873, § 4431; 2 Bright. Purd. Dig. Pa. 1873, p. 1217, § 26; 2 *Ibid.*, p. 794, § 16; 1 *Ibid.*, p. 121, § 24; 2 *Ibid.*, p. 996, § 20; Rev. Stats. N. J. 1877, p. 186, § 53; Gen. Stats. Neb. 1873, p. 201, § 141; Rev. Stats. Mo. 1879, § 931; Rev. Stats. S. C. 1873, p. 340, § 14.

[3] See the statute of New Jersey, quoted in the next section.

[4] Rev. Stat. Me. 1871, p. 425, § 10; Rev. Stats. N. Y. (Banks & Bros., 6th ed., 1876), vol. II., p. 398, § 2; 1 Cal. Civ. Code 1876, § 309; Civ. Code Dak. Ter., § 409; Rev. Stats. Mo. 1879, § 6025.

[5] 2 Bright. Purd. Dig. Pa. 1873, p. 1217, § 26; 2 *Ibid.*, p. 121, § 24; Ga. Code 1873, § 4431.

[6] Rev. Stats. S. C., p. 340, § 14.

[7] Rev. Stats. Wis. 1878, § 1765; 2 Bright. Purd. Dig. Pa. 1873, p. 1217, § 26; Rev. Code Md. 1878, p. 377, art. 9; Cod. Stats. Mont. 1871, p. 409, § 16; Rev. Stats. N. Y. (Banks & Bros., 6th ed., 1876), vol. II., p. 506, § 48.

[8] Rev. Stats. Wis. 1878, § 1765; Laws Wyo. 1869, p. 239, § 15; Rev. Stats. Mo. 1879, § 931; Rev. Stats.

capital is impaired,[1] or (3) when it is insolvent,[2] or (4) when the payment of the dividend would render it insolvent.[3]

§ 4291. What is not a Declaration of an Illegal Dividend under Such Statutes.—A transfer in good faith of all the assets of one corporation to another, for which the purchasing corporation issues to the stockholders of the selling corporation certificates of its stock, in lieu of the stock held by them in the selling corporation, is *not* a declaration of an illegal dividend, under the Missouri statute, such as renders the directors individually liable.[4] An illustration of the disposition of some judges to extend indulgence to corporate

N. Y. (Banks & Bros., 6th ed., 1876), vol. II., p. 708, § 13; *Ibid.*, p. 793, § 19; *Ibid.*, p. 729, § 36; *Ibid.*, p. 761, § 13; Gen. Laws Or. 1872, p. 527, § 15; Comp. Laws Ariz. 1877, § 3139; Rev. Code Md. 1878, p. 323, § 62.

[1] Conn. Gen. Stats. 1875, p. 280, § 16; Tenn. Acts 1875, p. 246.

[2] Ark. Dig. Stats. 1874, § 3355; Rev. Code Miss. 1871, § 2418; Gen. Stats. Vt. 1862 (Appendix 1870), p. 553, § 61; Rev. Stats. Wis. 1878, p. 1765; Bush Laws Fla. 1872, p. 170, § 26; Comp. Laws Kan. 1879, § 1095; Comp. Laws Nev. 1873, § 3841; Laws Wyo. 1869, p. 239, § 15; Rev. Stats. Texas 1879, p. 597, art. 4133 (railroad companies); *Ibid.*, p. 100, art. 594 (corporations generally); Rev. Stats. Mo. 1879, § 931; *Ibid.*, § 741; Cod. Stats. Mont. 1871, p. 409, § 16; Rev. Stats. N. Y. (Banks & Bros., 6th ed., 1876), vol. II., p. 506, § 48; *Ibid.*, p. 708, § 13; *Ibid.*, p. 702, § 7; *Ibid.*, p. 793, § 19; *Ibid.*, p. 729, § 36; *Ibid.*, p. 761, § 13; 2 Bright. Purd. Dig. Pa. 1873, p. 1410, § 31; Gen. Stats. R. I. 1872, p. 304, § 6; Rev. Stats. S. C. 1873, p. 361, § 31; Gen. Stats. N. H. 1867, p. 281, § 3; Gen. Laws Or. 1872, p. 527, § 15; Comp. Laws Mich. 1871, § 2310; Rev. Code Md. 1878, p. 323, § 62; Tenn. Acts 1875, pp. 258, 259.

[3] Ark. Dig. Stats. 1874, § 3355; Comp. Laws Ariz. 1877, § 3139; Rev. Code Miss. 1871, § 2418; Bush Laws Fla. 1872, p. 170, § 26; Comp. Laws Kan. 1879, § 1095; Comp. Laws Nev. 1873, § 3481; Laws Wyo. 1869, p. 239, § 15; Rev. Stats. Tex. 1879, p. 597, art. 4133 (railroad companies); *Ibid.*, p. 100, art. 594 (corporations generally); Rev. Stats. Mo. 1879, § 931; *Ibid.*, § 741; Cod. Stats. Mont. 1871, p. 409, § 16; Rev. Stats. N. Y. (Banks & Bros., 6th ed., 1876), vol. II., p. 506, § 48; *Ibid.*, p. 702; § 7; *Ibid.*, p. 708, § 13; *Ibid.*, p. 729, § 36; *Ibid.*, p. 761, § 13; *Ibid.*, p. 793, § 19; 2 Bright. Purd. Dig. Pa. 1873, p. 1410, § 31; Gen. Stats. R. I. 1872, p. 304, § 6; Rev. Stats. S. C. 1873, p. 361, § 31; Gen. Stats. N. H. 1867, p. 281, § 3; Gen. Laws Or. 1872, p. 527, § 15; Comp. Laws Ariz. 1877, § 3139; Thomp. & Steq. Tenn. Stats. 1871, § 1489; Comp. Laws Mich. 1871, § 2310; Rev. Code Md. 1878, p. 323, § 62. For a case arising under such a statute, see Rorke *v.* Thomas, 56 N. Y. 559.

[4] Skinker *v.* Taylor, 11 Mo. App. 592.

managers, in plain disregard of the language of statutes, is furnished in a decision of the Court of Appeals of New York, under a statute[1] of that State declaring that "whenever any *interest* or dividends shall be declared and credited, in excess of the interest or profits earned and appearing to the credit of the corporation, the trustees voting for such dividend shall be jointly and severally liable *to the corporation*, for the amount of such excess so declared and credited."[2] The court held that this statute does not limit the *interest* which lawfully may be voted for, to *net profits;* but that if a trustee votes for a dividend less than the *whole amount* of interest or profits earned, without any deduction therefrom for expenses, although the earnings have not been actually received, he does not, in the absence of fraud or bad faith, overstep his statutory duty, and he is not liable to the penalty.[3] The conclusion of the majority is that expenses are profits. There are no profits but *net profits*. To say that an amount of gross earnings which includes *expenses*, that which has been or must be *paid out*, is *profits*, is to commit the absurdity of saying that *loss* is *profit*.

§ **4292. Liable to the Corporation.**—Some of the statutes make the directors declaring the illegal dividend, or consenting thereto, liable *to the corporation* for the full amount or proportion of the capital so divided or withdrawn.[4] Some of the statutes make them liable to the corporation *and to the creditors*.[5] A comprehensive statute of New York, already quoted, makes the directors jointly and severally liable to the corporation and to the creditors thereof in the event of dissolution, to the full amount of the capital stock of the company so divided, withdrawn, paid out, reduced, etc.; and there are

[1] N. Y. Laws 1875, ch. 371.

[2] Rev. Stats. N. Y. (Banks & Bros., 6th ed., 1876), vol. II., p. 381, § 400.

[3] Van Dyck *v.* McQuade, 86 N. Y. 38, Folger and Earl, JJ., dissenting; reversing *s. c.* 45 N. Y. Super. Ct. 620; 57 How. Pr. (N. Y.) 62.

[4] Rev. Code, Md. 1878, p. 377, art. 9; 1 Bright. Purd. Dig. Pa. 1873, p. 121, § 24; *Ibid.*, p. 794, § 16. In the case of *railroad companies* the Pennsylvania statute makes the directors liable to the company "in an action of debt as in other cases." 2 Bright. Purd. Dig. Pa. 1873, p. 1217, § 26.

[5] Rev. Stats. N. J. 1877, p. 178, § 7.

statutes in other States drawn upon this model.[1] A right of action under such a statute accrues to a *receiver*, under a judgment dissolving the corporation.[2]

§ **4293. Remedies Given by the Statutes and Procedure thereunder.** — Some of these statutes prescribe the civil remedy to enforce the personal liability thus created. By the statute of Pennsylvania, "the directors consenting thereto shall be liable jointly and severally in any action of *debt*, *scire facias*, or *bill in equity*, in their individual capacities, to such corporation for the amount of the stock so divided," etc.[3] Under a statute of Maine, "all sums received for such dividends may be recovered by any creditor of the corporation in an *action on the case*."[4] By a statute of West Virginia, the remedy is by a *bill in equity* filed by a creditor.[5] A creditor seeking to enforce such a liability against a director must, at least, have an actionable demand against the corporation.[6] On general principles of equity, and without the aid of any statute, a corporation may recover money paid to a director of the company for dividends illegally declared; and a judgment creditor of such company, whose execution has been returned *nulla bona*, may subject to the satisfaction of his demand the money so paid, when the company is insolvent; and he need not bring the other creditors and stockholders of the company before the court.[7] When it is remembered that the courts regard statutes which impose this species of liability as *penal* statutes, it may easily be concluded that directors will not be personally charged, under such a statute, for declaring a prohibited dividend, except upon *strict proof*.[8]

§ **4294. Liable to Creditor Who is a Stockholder.** — Where a statute gives an action for an injury received from such a

[1] *Ante*, § 4290; Cal. Civ. Code, § 309; Civ. Code Dak. Ter., § 409; Rev. Stats. N. Y. (Banks & Bros., 6th ed., 1876), vol. II., p. 398, § 2.

[2] Van Dyck *v.* McQuade, 45 N. Y. Super. Ct. 620; *s. c.* 86 N. Y. 38.

[3] 1 Bright. Purd. Dig. Pa. 1873, p. 121, § 24.

[4] Rev. Stats. Me. 1871, p. 425, § 10.

[5] Rev. Stats. W. Va. 1879, p. 316, § 40.

[6] Hill *v.* Frazier, 22 Pa. St. 320.

[7] Gratz *v.* Redd, 4 B. Mon. (Ky.) 178.

[8] Slaymaker *v.* Jaffray, 82 Va. 346.

wrong of the directors, to a stockholder, as well as to a creditor, the stockholder is not estopped to maintain a suit against the directors by reason of his having received the dividend; since he may well have received it innocently. And even if such a fact were conceded, a good replication to a declaration under such a statute, the fact must be directly alleged; it cannot be made a matter of inference from the mere fact that he was a stockholder.[1]

§ 4295. Liability under These Statutes for Dividends Declared. — These statutes are penal in their nature,[2] and obviously do not make the directors liable where the dividend is declared in good faith, they believing at the time that the company is solvent, and upon reasonable grounds. Probably directors would not be held liable under such a statute, where the belief in the company's solvency was an error of judgment attributable to negligence, unless the negligence was of so gross and flagrant a character as, in the eye of the law, to be equivalent to actual fraud.[3] On the other hand, it is immaterial what form the transaction takes. If, in point of fact, it amounts to a distribution of the assets of the company among its shareholders while the company itself is insolvent, it will render the directors liable under such a statute.[4] Some of the statutes impose an individual liability upon the directors for declaring a dividend when the corporation is *insolvent*.[5] Where an action is brought to charge the directors under such a statute, the question whether the corporation was insolvent at the date of the dividend is a *question of fact*, and of course the plaintiff must establish it by sufficient proof.[6] A statute repealing an individual liability predicated upon the declara-

[1] Gaffney *v.* Colvill, 6 Hill (N. Y.), 567, 575.

[2] *Ante*, § 4164.

[3] Consult, on this principle, Charitable Corporation *v.* Sutton, 2 Atk. 400; *s. c.* Thomp. Off. Corp. 226; Spering's Appeal, 71 Pa. St. 11; *s. c.* 10 Am. Rep. 684; Thomp. Off. Corp. 238; Gaffney *v.* Colvill, 6 Hill (N. Y.), 567.

[4] See, for illustration, the following somewhat complicated case: Rorke *v.* Thomas, 56 N. Y. 559.

[5] Code Va. 1873, ch. 57, § 33.

[6] Slaymaker *v.* Jaffray, 82 Va. 346; *s. c.* 4 S. E. Rep. 606.

tion of an unlawful dividend is of general application to all existing corporations in its relation to debts thereafter created.[1] In declaring upon such a statute it is not necessary to allege that the defendants *knowingly* paid the dividends, since it is their duty to know, and ignorance is no defense.[2]

Article X. Miscellaneous Liabilities and Penalties.

Section
4298. Acting as agent of foreign insurance company which has not complied with the domestic law.
4299. Doing business for the corporation without a license.
4300. Receiving deposits and creating debts while insolvent.
4301. Whether such a constitutional provision self-enforcing.
4302. Official mismanagement.
4303. Liability of directors under the National Banking Act.
4304. Whether the right of action given by this section is lodged alone in a receiver.
4305. Resignation of such directors.

§ 4298. Acting as Agent of Foreign Insurance Company Which has not Complied with the Domestic Law. — It may be assumed that statutes exist in every State prescribing the conditions on which foreign insurance companies, and insurance companies chartered or organized in other States, may do business within the particular State; and the well-known rule of constitutional law that, the business of insurance not being interstate or foreign commerce, and not concerning Federal relations, such companies may be kept out entirely, and for stronger reasons regulated at will,[3] may be here adverted to. These statutes begin by prescribing the terms upon which such insurance companies may do business within the State, and then they impose penalties upon the agents of such companies who presume to do business within the State until such terms have been complied

[1] Slaymaker *v.* Jaffray, 82 Va. 346; *s. c.* 4 S. E. Rep. 606. That the declaration of a dividend when the corporation has no profits to divide and is embarrassed, does not create a debt in favor of each of the stockholders upon which recovery may be had, — see Slayden *v.* Seip Coal Co., 25 Mo. App. 439; also Lexington &c. Ins. Co. *v.* Page, 17 B. Mon. (Ky.) 412, 442; *s. c.* 66 Am. Dec. 165; *ante*, § 94.

[2] Gaffney *v.* Colvill, 6 Hill (N. Y.), 567, 576; *ante*, § 4108.

[3] *Post*, ch. 195.

with.[1] It has been held that where a property owner applies to an agent for a policy of insurance upon his property, and directs him that if he cannot give him a good company to send his money back, and the agent procures the policy to be written by a *foreign company* which has not complied with the statutes of the State so as to be entitled to write policies therein, the agent in effect *guarantees* the solvency of the company, and becomes personally responsible for the loss.[2] Outside of any statute creating such a liability, a person acting as agent of a foreign corporation which is without license to do business in the domestic State, becomes liable personally to make good the contracts which he has assumed to make in the name of the foreign corporation, on the theory of breach of warranty of agency.[3]

§ 4299. Doing Business for the Corporation without a License. — Where a corporation has, under its charter, the power to invest its surplus funds in stocks, funded debts, etc., and to sell and transfer the same at pleasure, its directors are not liable to *indictment* under a statute, for engaging the corporation in the business of buying and selling for its own account such securities, where it does not thus engage as a *broker* for third persons.[4]

§ 4300. Receiving Deposits and Creating Debts while Insolvent. — Many constitutional ordinances and statutes

[1] Gen. Stats. Mass., p. 332, ch. 58, § 74. See also Mass. Acts 1873, ch. 141, § 11; Supp. to Gen. Stats. Mass. vol. II., p. 16; *Ibid.*, p. 581; Mass. Acts 1867, ch. 267, § 5; Comp. Laws Nev. 1873, § 3949 (misdemeanor — fine $2,000); Gen. Stats. N. H. 1867, p. 327, § 3 (fine $500, one-half to the prosecutor); Rev. Stats. N. J. 1877, p. 508, § 8; pp. 1348, 1349, §§ 6, 9 (fine $500); 1 Bright. Purd. Dig. Pa. 1873, p. 799, § 39 (penalty, $500); Gen. Stats. R. I. 1872, p. 316, § 16 (fine $1,000); Gen. Stats. Vt. 1862 (Appendix 1870), p. 557, § 13 (forfeiture not exceeding $300, nor less than $500); Comp. Laws Mich. 1871, §§ 1683, 1689 (fine not less than $15, nor more than $100); Rev. Stats. N. Y. (Banks & Bros., 6th ed., 1876), vol. II., p. 664, § 61; Laws Nev. 1877, p. 58, § 2.

[2] Morton *v.* Hart, 88 Tenn. 427; *s. c.* 12 S. W. Rep. 1026; 19 Ins. L. J. 347.

[3] Lasher *v.* Stimson, 145 Pa. St. 30; *s. c.* 23 Atl. Rep. 552.

[4] Henderson *v.* State, 50 Ind. 234.

exist, prohibiting the directors and other officers of banking corporations from receiving deposits of money or other valuable things, or creating debts, while the institution is insolvent. Some of these statutes make the offense a *misdemeanor*,[1] others a *felony;*[2] some declare the offenders guilty of *larceny*,[3] others of embezzlement;[4] many impose a *personal civil liability* upon the directors for the obligation so created,[5] and some add a provision for contribution among them;[6] and one provides for a *survivorship* of the right of action against *executors* and *administrators*.[7]

§ 4301. Whether Such a Constitutional Provision Self-enforcing. — The provision of the constitution of Missouri on this subject is as follows: "It shall be a crime, the nature and punishment of which shall be prescribed by law, for any president, director, manager, cashier, or other officer of any banking institution, to assent to the reception of deposits, or the creation of debts, by such banking institution, after he shall have had knowledge of the fact that it is insolvent or in failing circumstances; and any such officer, agent, or manager shall be individually responsible for such deposits so received, and all such debts so created with his assent."[8] In a well-considered decision, the St. Louis Court of Appeals held that the latter clause, creating a civil liability, is self-enforcing, not being affected by the previous clause referring it to the Legislature to prescribe the nature and punishment of the

[1] Cal. Pen. Code, § 562; Comp. Laws Utah 1876, p. 635, § 323; Comp. Laws Mich. 1871, § 2201.

[2] Iowa Act of April 3, 1880; Sess. Acts S. C. 1877, p. 232, Act No. 216.

[3] Rev. Stats. Mo. 1879, § 1350; Comp. Laws Kan. 1879, § 1818. The Missouri statute is not applicable to *private* bankers: State *v.* Kelsey, 89 Mo. 623; *s. c.* 1 S. W. Rep. 838.

[4] Hurd Rev. Stats. Ill. 1880, p. 358, § 25 *a*.

[5] Const. Wash. 1889–90, art. XII., § 12; Comp. Laws Kan. 1879, § 479; Const. La. 1879, art. 241 (applicable to any *private* or public bank); Rev. Stats. Mo. 1879, § 918; Sess. Acts S. C. 1877, p. 232, Act No. 216.

[6] Comp. Laws Kan. 1879, § 479; Rev. Stats. Mo. 1879, § 918.

[7] Rev. Stats. Mo. 1879, § 920. Example of a good petition under such a statute: Cummings *v.* Winn, 89 Mo. 51.

[8] Const. Mo., art. XII., § 27.

crime thereby declared; and the court took the view that such civil liability might be enforced by the ordinary remedies existing at the time of the adoption of the constitution.[1] But the Supreme Court of Missouri held otherwise in a decision which is not entitled to the least respect.[2] Subsequently to this decision, the Legislature of Missouri enacted a statute, following substantially the language of the constitution, and making directors receiving deposits in violation of the statute jointly and severally liable, but without prescribing *to whom* they should be liable. It was held that this statute would not support an action against the directors by a depositor.[3] This decision is believed to be unsound; since where a statute declares a liability and gives a right of action, the principles of the common law will extend the right to any one injured by the wrong denounced by the statute; and it is to be noted that a Federal judge within the State of Missouri, a year after this decision was rendered, submitted a case to a jury under the same statute, where the action was brought against a director by a depositor.[4]

§ **4302. Official Mismanagement.**—As a general rule, official mismanagement by the directors of a corporation is an offense against the corporation only, and not against creditors; but there are a few statutes which make this an actionable injury to creditors. Thus, by a statute of Pennsylvania, for *official misconduct* in general, where no other punishment is prescribed by the Pennsylvania statutes, the officer shall be deemed to have committed *larceny*, and shall be fined not exceeding one thousand dollars, and be imprisoned in the county jail or penitentiary not exceeding three years.[5] A statute of

[1] Cummings *v.* Spaunhorst, 5 Mo. App. 21.

[2] Fusz *v.* Spaunhorst, 67 Mo. 256.

[3] Fischer *v.* Tamm, 13 Mo. App. 108.

[4] Dodge *v.* Mastin, 17 Fed. Rep. 660. That the Pennsylvania statute making it a criminal offense to receive deposits while a bank is insolvent does not create a *felony*, see Com. *v.* Schall, 12 Pa. Co. Ct. 554.

[5] Bright. Purd. Dig. Pa. 1873, p. 132, § 33. In Rhode Island bank officers guilty of fraudulent management may be fined not exceeding $5,000. Gen. Stats. R. I. 1872, p. 297, § 35.

Maine provides that "those directors, by whose mismanagement a loss or deficiency of capital stock occurs, shall be liable therefor in their individual capacity," etc.[1] By another section of the same statute, a suit in *equity* to enforce this liability is given to the holders of unredeemed bills. It will be observed that this liability is the same as exists at common law, except as to the persons toward whom it flows. At law the liability for negligence is to the corporation only; in equity it is to the corporation immediately, and to the directors mediately.[2] Under this statute it is ruled that directors, to avoid liability, are obliged to take the same care as factors or agents. They are answerable, not only for any fraud and gross negligence which they may be guilty of, but also for all faults that are contrary to the care required of them. They are answerable for ordinary neglect, and this means the omission of that care every man of common prudence takes of his own concerns.[3] When, therefore, the directors *discounted paper* on the pledge of stock, *in violation of the statute*, on irresponsible names,—those of day-laborers, clerks, and bankrupts,—they were held liable. But they were not liable for *renewing* worthless paper which was discounted by their predecessors, for the conclusive reason that the bank sustained no loss on account of such renewals.[4]

§ 4303. Liability of Directors under the National Banking Act.—The National Banking Act contains this provision: "If the directors of any national banking association shall

[1] R. S. Me. 1857, ch. 47, § 43.

[2] *Ante*, § 4090, *et seq.*

[3] Quoting and following Scott *v.* Depeyster, 1 Edw. Ch. (N. Y.) 513, 547; Domat. 132, tit. 3, § 2.

[4] Bank of Mutual Redemption *v.* Hill, 56 Me. 385; *s. c.* 96 Am. Dec. 470. The Maine statute of 1831, "to regulate banks and banking," ch. 519, § 28, gave a remedy only to creditors of a bank, as holders of its bills or otherwise, and not to the stockholders, against the directors thereof, for losses arising "from the official mismanagement of the directors." Rich *v.* Shaw, 23 Me. 343; Rev. Stats. Me. 1871, p. 410, § 42. Construction of obsolete Pennsylvania statute relating to the *fraudulent insolvency* of banks and the consequent personal liability of the directors, with the conclusion that there is no *prima facie* imputation of fraud springing from the mere fact of insolvency: Wright *v.* Davenport, 66 Pa. St. 148.

knowingly violate, or knowingly permit any of the officers, agents, or servants of the association to violate, any of the provisions of this title, all the rights, privileges, and franchises of the association shall be thereby forfeited. Such violation shall, however, be determined and adjudged by a proper circuit, district, or territorial court of the United States in a suit brought for that purpose by the Comptroller of the Currency, in his own name, before the association shall be declared dissolved. And in cases of such violation, every director who participated in or assented to the same shall be held liable, in his personal and individual capacity, for all damages which the association, its shareholders, or any other person, shall have sustained in consequence of such violation."[1] It may assist in the construction of this act in future cases to note that it is almost literally transcribed from an early statute of Pennsylvania.[2] Two questions have arisen in different circuits of the United States concerning the right of action given by this section, and both have been answered differently. The first is whether the action given by it against directors may proceed *before* the Comptroller has, in a direct proceeding to forfeit the franchises of the banking association by reason of the violation of the act by the directors, procured an adjudication of such forfeiture, establishing the fact of such violations of the act. The Circuit Court of the United States for the Eastern District of Missouri has held that such an adjudication is not necessary;[3] and the Circuit Court of the United States for the Eastern District of Virginia has held that it is.[4] The latter decision is obviously unsound. There is no connection between the subject of forfeiting the franchises of the corporation and making the directors liable, except that the draughtsman has placed them in the same section. Forfeiting the franchises would theoretically redress the fictitious public wrong and punish the innocent

[1] Rev. Stat. U. S., § 5239.

[2] 1 Bright. Purd. Dig. Pa. 1873, p. 124, § 40.

[3] Stephens *v.* Overstolz, 43 Fed. Rep. 465.

[4] National Exch. Bank *v.* Peters, 44 Fed. Rep. 13.

shareholders, but holding the directors liable would redress the *real wrong*.

§ 4304. Whether the Right of Action Given by This Section is Lodged Alone in a Receiver. — In the case just referred to,[1] the Circuit Court of the United States for the Eastern District of Virginia also holds that the right of action given by the section already quoted is lodged alone in a receiver of the national banking corporation; while the intimations of the decision of the Circuit Court of the United States for the Eastern District of Missouri are to the contrary.[2] The court in Virginia holds that a creditor of such a corporation cannot sue its directors, for the purpose of charging them with the *damages* which he has sustained through their *mismanagement* of the institution. The court reasons that no such action exists at common law, and in this, as already seen, the court is correct. The court next concludes that no such action is given by the statute; but in so holding the court proceeds in the very face of the language of the statute: "And in case of such violation, every director who participates in or assents to the same shall be held liable in his individual capacity for all damages *which the association, its shareholders, or any other person*, shall have sustained in consequence of such violation." It must strike the attention that a more comprehensive frame of language could not have been devised by the draughtsmen of the statute, so as to make it include both *stockholders* and *creditors*. The right of action thus given does not, upon any sound principle, reside exclusively in the receiver. He represents the creditors first, and the shareholders next, for the purpose of collecting the *assets of the association*. He may indeed sue for and recover the damages which the association may have sustained through their illegal acts; but it is to be observed that, for the recovery of such damages, the statute gives a right of action to "its shareholders or any other person who shall have sustained damages in consequence of such

[1] National Exch. Bank *v.* Peters, 44 Fed. Rep. 13.

[2] Stephens *v.* Overstolz, 43 Fed. Rep. 465.

violation." Now, damages which its shareholders may have sustained, do not belong to the corporation, and cannot therefore be sued for by its receiver. Nor can the receiver sue for such damages as the representative of its creditors, for they belong to the shareholders, and not to the creditors. Then as to the damages which "any other persons" — that is, any person other than the shareholders, may have sustained by reason of such violation, it would be absurd to call such damages assets of the corporation, or to hold that a right of action for them is vested in its receiver. It is exceedingly plain that the statute gives three actions against the directors: 1. An action by the association, which of course passes to its receiver as its legal representative; 2. And by its shareholders, who in law are separate and distinct persons from the corporation, and which right of action is therefore not assets of the corporation; 3. By any other person, which would include creditors, or others who might be damaged by the acts of the directors in violation of the statute, — which last right of action cannot, on any theory, be regarded as belonging to the corporation or its representative.

§ **4305. Resignation of Such Directors.** — Where a director of a national banking association agreed to sell his stock, the price of which he afterwards received, and orally resigned his office of director to the president of the bank, in his place of president at the bank, it was held that he thereupon ceased to be a director, and was not liable for subsequent losses sustained by negligence of the directors.[1]

Article XI. Remedies and Procedure Under These Statutes.

Section
4308. Preliminary.
4309. Whether the remedy is at law or in equity.
4310. Doctrine of Supreme Court of United States: remedy in equity.

[1] Movius *v.* Lee, 30 Fed. Rep. 298; *s. c.* affirmed *sub. nom.* Briggs *v.* Spaulding, 141 U. S. 132.

SECTION
4311. So in Massachusetts.
4312. So in Georgia.
4313. So in Alabama.
4314. So in other States under various statutes and charters.
4315. In Kentucky, remedy at law.
4316. So in Missouri where equitable relief not sought.
4317. So in Vermont.
4318. So in New York.
4319. So, it seems, in Indiana.
4320. Action by single creditor against single director.
4321. Form of the action at law.
4322. Actions by creditors.
4323. Actions by receivers.
4324. Actions by assignees.
4325. Actions by stockholders.
4326. Actions by Attorney-General in New York.
4327. Judgment against corporation a condition precedent.
4328. Exception in case of inchoate corporations.
4329. Exception in some States.
4330. Theory that judgment against corporation conclusive.
4331. Theory that such judgment not evidence against the directors.
4332. Whether judgment against corporation by garnishment a sufficient foundation for such an action.

SECTION
4333. Burden of proof under such statutes.
4334. Parol evidence admissible to identify the judgment.
4335. Misjoinder of such causes of action.
4336. Pleading under such statutes: complaint must allege all the statutory grounds of recovery.
4337. What exceptions of the statute must be negatived.
4338. Averment of date of debt.
4339. Averment that the debt remains unpaid.
4340. Misdescription of the statute immaterial.
4341. Not necessary to aver how the damage happened.
4342. Other points in such complaints.
4343. Plaintiff recovers upon a preponderance of evidence.
4344. Procedure in case of the death of a director.
4345. Rule in Massachusetts in case of insolvency proceedings against director.
4346. Other decisions under statutes of Massachusetts.
4347. Costs in proceedings under these statutes.
4348. Various matters of practice in such actions.

§ **4308. Preliminary.** — Some of the statutes which we have been considering give special remedies for the special liabilities created by them. Such statutes, except in so far as they are declaratory of the common law, are subject to the well-known rule that where a statute creates a right and gives a remedy to enforce that right, that remedy is exclusive. But, contrary to this principle, it has been held that where the charter makes the directors liable jointly and severally for the corporate debts, though it gives an action against them, the statutory remedy by such action is not exclusive. The reasoning is that the creditors of the corporation are

creditors of the directors, and may pursue them or their property by the general methods of the law, *e. g.*, attachment.[1]

§ 4309. Whether the Remedy is at Law or in Equity. This question depends so much on the terms of particular statutes, and on the remedial systems of the different States, that it is not surprising that there should be such a conflict of decisions with regard to it as to preclude any attempt to reconcile the cases. Where the statute does not expressly require the remedy to be pursued at law, we believe the better doctrine is that the remedy of the creditor should be sought in equity; for, notwithstanding these statutes are generally regarded as penal, yet, the object of the Legislature in enacting them is to create an additional security for *all* the creditors of the corporation; and this policy is in a measure defeated by allowing a proceeding whereby those who succeed in first prosecuting their claims to judgment exhaust the security and leave the others unpaid. Moreover, if the statute is penal, and is to be favorably construed toward the persons against whom the penalty is denounced, and if there is a fair question as to the remedy to be pursued in enforcing it, that remedy ought to be chosen which will be least oppressive to them. In these cases the least oppressive remedy for the directors is that of the courts of equity; for this saves them from being harassed by a multiplicity of suits; it exhausts the assets of the corporation before charging them; it affords an opportunity for enforcing contribution among themselves where the right to contribution exists, and it gives scope for the adjusting of all conflicting equities among the parties, such as may arise where the creditor is himself a shareholder or a director. Opposed to this reasoning is the suggestion that courts of *equity* never sit to enforce *penalties;* and from this the conclusion has been deduced that where the liability is imposed upon directors in favor of creditors for a particular act, and a court of equity is clothed with the jurisdiction to enforce it, the statute is not penal for that very reason.[2]

[1] Ex parte Van Riper, 20 Wend. (N. Y.) 614.

[2] Woolverton *v.* Taylor, 132 Ill. 197; *s. c.* 22 Am. St. Rep. 521.

§ 4310. Doctrine of Supreme Court of United States: Remedy in Equity. — The Supreme Court of the United States has taken this view of the remedy under a statute of the District of Columbia. This statute provided that "if the *indebtedness* of any company organized under this act shall at any time *exceed* the amount of its *capital stock*, the trustees of such company, assenting thereto, shall be personally and individually liable for such excess, to the creditors of the company."[1] In giving the judgment of the court, Mr. Justice Miller said: "The remedy for this violation of duty as trustees is in its nature appropriate to a court of chancery. The powers and instrumentalities of that court enable it to ascertain the excess of indebtedness over the capital stock, the amount of this which each trustee may have assented to, and the extent to which the funds of the corporation may be resorted to for the payment of the debts; also, the number and names of the creditors, the amount of their several debts; to determine the sum to be recovered of the trustees and apportioned among the creditors, — in a manner which the trial by jury and the rigid rules of common-law proceedings render impossible. This course . . . . adjusts the rights of all concerned on the equitable principles which lie at the foundation of the statute."[2] So, it has been held in the Circuit Court of the United States, that a creditor of a dissolved corporation, the assets of which have been misappropriated by the directors, can only maintain an action against them after an ascertainment in equity of the amount due him, unless his claim is the only one that the corporation owed at the time of its dissolution, or unless the assets appropriated by the directors exceed such claim in amount.[3]

§ 4311. So in Massachusetts. — In Massachusetts, the remedy by an action at law, to recover of an officer of a cor-

[1] See *ante*, § 4259, *et seq.*

[2] Hornor *v.* Henning, 93 U. S. 228, 232; reaffirmed in Stone *v.* Chisolm, 113 U. S. 302.

[3] Horner *v.* Carter, 3 McCrary (U. S.), 595. So under a similar statute in Illinois: Buchanan *v.* Bartow Iron Co., 3 Ill. App. 191; Buchanan *v.* Law, 3 Ill. App. 202.

poration a corporate debt, which existed under the general statutes,[1] has been expressly repealed by a later statute,[2] and a suit in equity substituted therefor, which is now the only remedy.[3] The liability of directors of manufacturing corporations, under a statute of that State, making directors liable for the debts of the corporation above its capital stock could, in like manner, be enforced only in equity.[4]

§ 4312. So in Georgia. — So in Georgia, where a statute made directors of a bank liable for certain official defaults, to the creditors of the corporation, and these defaults amounted to a *gross fraud upon the public*, it was held that an action to enforce the liability might be brought by any judgment creditor in equity by or on behalf of himself and of others standing in the same situation as himself. The court so ruling, keeping in view the doctrine that the capital stock of a corporation is a *trust fund* for its creditors, and that whenever a bank issues bills, a superior equity or trust arises in favor of those who receive or become holders of them, over that which has arisen in favor of the stockholders, on the part of the president, cashier, and directors of the bank, as custodians

[1] Gen. Stats. Mass., ch. 60, § 31.

[2] Mass. Act 1862, ch. 218, § 10.

[3] Peele *v.* Phillips, 8 Allen (Mass.), 86; Bond *v.* Morse, 9 Allen (Mass.), 471. This last statute was held to apply to corporations organized under general laws, as well as to those organized under special statutes. So, under Pub. Stats. Mass., ch. 106, § 60, cl. 3, affixing a personal liability to the directors of manufacturing corporations for contracting excessive debts, the remedy is in equity. Thacher *v.* King, 156 Mass. 490; *s. c.* 31 N. E. Rep. 648.

[4] Merchants' Bank *v.* Stevenson, 10 Gray (Mass.), 232. An action *at law* cannot be maintained by a creditor of a corporation against its officers, to enforce the officers' liability imposed by Mass. Stat. 1863, ch. 246, § 2. A bill in equity is now the only remedy. McRae *v.* Locke, 114 Mass. 96. The objection to such a proceeding at law is not *waived* by the submission of the case upon an *agreed statement* of the facts necessary for the determination of the question of liability. *Ibid.* See also Crease *v.* Babcock, 10 Met. (Mass.) 525. *Requisites* of a *bill in equity* under Mass. Stat. 1862, ch. 218, to charge the officers of a manufacturing corporation, personally, with a debt thereof: Norfolk *v.* American Steam Gas Co., 108 Mass. 404; Thayer *v.* New England Lith. &c. Co., 108 Mass. 523. The following are statutes of Massachusetts relating to this subject: Gen. Stats. Mass., p. 385, ch. 68, § 17; Supp. to Gen. Stats. Mass., vol. I., p. 811, § 42.

of such fund, — has placed this jurisdiction on the ground of *trust*. "It is true," said the court, "that the bill is not filed under the charter. It is filed on the principle that trustees guilty of a breach of trust shall be responsible to those aggrieved by it; and that if the trustees have, or are presumed to have, made any advantage by it, then it is against conscience that they or their representatives should be allowed to retain this advantage. They should respond to injured parties." The jurisdiction of equity in this case was held not ousted by the fact that the plaintiff might have a suit at law, for the remedy in equity is more effective than that at law.[1]

§ **4313. So in Alabama.** — So in Alabama, where the jurisdiction was aided by statute, it was held that the note-holders of a foreign banking corporation, which had suspended payment, might, without first obtaining judgment at law, proceed in equity against the bank, its directors, stockholders, and agents, charging them with fraud and a misapplication of the assets, and seeking a discovery and account. Such a bill, it was said, might be maintained under the general powers and jurisdiction of the court, which regards the capital stock of the company and all its assets as a trust fund for the payment of its creditors, and the directors, stockholders, and agents, as trustees. As against the bank, if the bill was verified by affidavit, and alleged that the bank was located in another State, and had property and choses in action in Alabama, it might also be sustained under the attachment law of 1846; and if it further alleged that the notes were issued and put in circulation in this State by the president, who was charged to be the principal stockholder and a non-resident, it was also well filed against him under the act.[2]

§ **4314. So in Other States under Various Statutes and Charters.** — The same rule obtains in other States, under various statutes and charters.[3]

[1] Schley *v.* Dixon, 24 Ga. 273, 279; *s. c.* 71 Am. Dec. 121.

[2] Bank of St. Mary's *v.* St. John, 25 Ala. 566.

[3] Comp. Laws Mich. 1871, § 6572, *et seq.;* Crown *v.* Brainerd, 57 Vt. 625;

§ **4315. In Kentucky, Remedy at Law.**—The Court of Appeals of Kentucky have taken a different view of this question from that taken by some of the other courts,[1] holding that, under a statute making directors individually liable, jointly and severally, for corporate debts contracted beyond a prescribed limit,[2] the remedy is *at law.* In the view of the court, the personal liability of a director under this statute may be enforced by one creditor without inquiring for others, or requiring them, if there be any, to be made parties. Such a case, say the court, is not that of an assignment, but the liability is to each creditor severally, who, according to the nature of the case and under the eighteenth section of the same statute, may maintain a separate action.[3]

§**4316. So in Missouri where Equitable Relief not Sought.** In Missouri where the remedial systems of law and equity are blended under a code of procedure, an action in the nature of an action at law may be prosecuted by the receiver of an insolvent corporation against its directors, to recover damages sustained by the corporation through their misconduct in office, where no accounting or other equitable relief is required.[4]

§ **4317. So in Vermont.**—A statute of Vermont provided that "the directors shall be liable to pay the creditors and stockholders of such bank all losses which may be sustained in consequence of any violation by them of the provisions of the banking laws of the State, or other unfaithfulness in the discharge of their official duties; and any number of such directors may be sued in the same action by any claimant under the provisions of this section."[5] It is held that any stockholder injured by a violation of this statute may maintain an *action at law* against any director, without joining the

Rev. Stats. N. J. 1877, p. 194, § 94; Citizens' Loan Asso. *v.* Lyon, 29 N. J. Eq. 110. But under another statute the remedy is by action *on the case:* Rev. Stats. N. J. 1877, p. 194, § 93.

[1] *Ante,* §§ 4268, 4310, *et seq.*

[2] 2 Stant. Ky. Stat., p. 517, § 16.

[3] Cornwall *v.* Eastham, 2 Bush (Ky.), 561.

[4] Thompson *v.* Greeley, 107 Mo. 577, 593.

[5] Vt. Act 1862, ch. 218, § 10.

other stockholders. The reason given by the court was, that if one stockholder could not maintain the action, no number less than the whole could do so. This would present the incongruous result, either of having some of the parties on both sides of the record, or of denying the right of any suit at law at all. Then, too, to hold that all should join in such suit would require a disregard of the well-known rule that only those who have a joint right should join in the suit for its enforcement; for the right of the stockholder is several, and not joint.[1] So where a statute points out certain duties to be performed by directors of corporations, and provides that if the president and clerk or secretary of any such corporation shall neglect or refuse to perform such duties, "they shall be severally and personally responsible, in an action *founded upon this statute*, for all debts of such corporation, contracted during the period of any such neglect or refusal," it has been held that a bill in equity will not lie: the expression "action founded on this statute," means an action at law.[2] So, where the charter of a corporation made the directors and stockholders personally liable to the creditors if the debts should at any time exceed three-fourths the amount of the capital stock, but provided no means of enforcing this liability, — it was held that creditors might resort to their common-law action, that under the common law the clause would make them jointly liable for the debts, but that it extended only to those who were directors and stockholders at the time the indebtedness was so increased.[3]

§ **4318. So in New York.** — So, under an early conception in New York, the directors of a moneyed corporation were responsible in an *action on the case*, for improperly obtaining and disposing of its funds or other property;[4] and so, under the New York statute making every director in certain cor-

[1] Buell *v.* Warner, 33 Vt. 570.

[2] Bassett *v.* St. Alban's Hotel Co., 47 Vt. 313; Gen. Stats. Vt. 1863, ch. 86, §§ 58, 63. Compare *ante*, § 3414.

[3] Windham &c. Inst. *v.* Sprague, 43 Vt. 502.

[4] Franklin Fire Ins. Co. *v.* Jenkins, 3 Wend. (N. Y.) 130.

porations personally liable for their debts not exceeding a specified amount, such liability is an original joint and several contract liability, which may be enforced by a single creditor in an action at law, without previous effort to collect from the corporation.[1]

§ 4319. So It Seems in Indiana.—A Federal court has held, under a statute of Indiana, that an action of debt may be maintained against the officers of a corporation, where under its charter they are made liable individually for the corporate debts, if they neglect to publish certain reports required by the charter.[2]

§ 4320. Action by Single Creditor against Single Director. When it is conceded that the remedy under these statutes inures to creditors,[3] if the rule of the jurisdiction allows it to be prosecuted by an action at law, then it follows that a *single creditor* may maintain the action against one or more of the directors, and that he is not obliged either to proceed for other creditors or to proceed against all the directors guilty of the delinquency denounced by the statute.[4]

§ 4321. Form of the Action at Law.—Although statutes of the class we are considering are generally regarded as penal, it does not follow that an action upon them is necessarily in form *ex delicto*. As is well known, an action of *debt* lies to recover a *penalty* given by a statute;[5] and it has been held that this form of action may be resorted to under a statute making the directors of corporations "jointly and severally liable for all the debts of the company" in consequence of being guilty of certain official defaults; provided the sum sought to be recovered is a sum certain.[6] This form of action is sometimes given by statute in express terms.

[1] State Bank *v.* Andrews, 18 N. Y. Supp. 167.

[2] Union Iron Co. *v.* Pierce, 4 Biss. (U. S.) 327.

[3] *Ante*, § 4163.

[4] State Bank *v.* Andrews, 18 N. Y. Supp. 167.

[5] Sturges *v.* Burton, 8 Ohio St. 215; *s. c.* 72 Am. Dec. 582.

[6] Union Iron Co. *v.* Pierce, 4 Biss. (U. S.) 327, McDonald, J. This case was decided under the thirteenth section of the Indiana statute relating to mining and manufacturing companies: 1 Gav. & H. Stats. 425.

§ 4322. **Actions by Creditors.**—Under nearly all these statutes the liability is in terms *to creditors*, and of course they are the proper persons to sue. This has been shown in the preceding sections. Under section 10 of the New York statute relating to moneyed corporations, a creditor cannot maintain an action to charge directors for acts done by them which rendered the corporation insolvent *before* he became its creditor. Such loss or injury is too remote to be charged to the acts of the directors.[1] In *Minnesota*, a creditor of the corporation may sue one or more of the directors to enforce the liability *without joining all the creditors* to whom they are liable, or all the directors subject to the liability,[2]—which is tantamount to holding that the remedy is *at law*.[3]

§ 4323. **Actions by Receivers.**—Whether a receiver of a corporation can sue for penalties given by statute for official defaults of the directors must depend, for the most part, upon the terms of the statute in each case; but this inquiry may be aided by principles which are discussed in a succeeding chapter.[4] If the statute make the penalty a *debt due to the corporation*, for a breach of duty on the part of the directors toward the corporation, then it is clear that the receiver, who succeeds to the title of the corporation, can bring the suit. Whether he can sue, we take it, must depend upon the question whether the penalty is made by the statute a part of the *corporate assets*, which it is the duty of the receiver to collect and distribute ratably among all the creditors, or whether it is a debt by statute due from any director, guilty of the particular default, to any creditor of the corporation who may choose to sue therefor. Under a statute of New York, passed in 1825, to prevent fraudulent bankruptcies of corporations,[5] the penalty incurred by the directors of a bank, for dividing the capital stock of the bank among the

[1] Ogden *v.* Rollo, 3 Abb. Pr. (N. Y.) 300.

[2] Patterson *v.* Stewart, 41 Minn. 84; *s. c.* 16 Am. St. Rep. 671; 42 N.W. Rep. 926.

[3] *Ante*, §§ 4174, 4176.

[4] *Post*, ch. 161. See also Van Cott *v.* Van Brunt, 2 Abb. N. Cas. (N. Y.) 283.

[5] Laws N. Y. 1825, p. 448.

stockholders, was held to be a *debt due to the corporation*, under the terms of the statute, which provided that the individuals who should incur the penalty should be liable therefor "to the said corporation, and to the creditors thereof in the event of its dissolution."[1] The court therefore concluded that suit could be brought by a receiver of the corporation.[2] In Missouri, although there is no statute conferring upon a receiver the power to prosecute an action against the directors of a corporation to recover damages for a loss of the assets of the corporation through their misconduct, yet it is held competent for the court appointing the receiver to direct that such an action be brought, it being within the general jurisdiction of a court of equity powers.[3]

§ **4324. Actions by Assignees.** — It has been held in Pennsylvania that where a corporation makes an *assignment for the benefit of its creditors*, it is the duty of the assignee to bring suit against the directors, if they have declared dividends out of the capital stock in violation of statute. If the assignee fails to do this, it will be good ground for exception to his final account, and he will be personally liable to an amount which might have been realized by the bringing and prosecuting of such suits.[4]

§ **4325. Actions by Stockholders.** — Although the stockholders of a corporation are, in the eye of a court of equity, the *cestuis que trust* of the directors,[5] yet in the eye of the courts of law they are strangers to them.[6] The stockholder may make contracts with the corporation through the directors, or their managing or contracting officers. He may sue it

[1] See statutes of this kind, *ante*, §§ 4314–4319.

[2] Bank of Niagara *v.* Johnson, 8 Wend. (N. Y.) 645.

[3] Thompson *v.* Greeley, 107 Mo. 577; Thompson *v.* Swain, 107 Mo. 594.

[4] Gunkle's Appeal, 48 Pa. St. 13. See also Grocers' National Bank *v.* Clark, 48 Barb. (N. Y.) 48.

[5] *Ante*, § 4009.

[6] Smith *v.* Hurd, 12 Met. (Mass.) 371; *s. c.* 46 Am. Dec. 690; Thomp. Off. Corp. 249; Willoughby *v.* Comstock, 3 Hill (N. Y.), 389; Brinham *v.* Wellersburg Coal Co., 47 Pa. St. 43, 49.

and be sued by it, and for the frauds of the directors committed upon him he may, like any other stranger, maintain an action at law for deceit.[1] There is, therefore, nothing in his relation towards the directors of the company which will prevent him, in the event he becomes a creditor of the company, from maintaining an action to charge the directors with the liability to pay the debts of the company, imposed upon them by statute for certain official defaults.[2] Thus, the directors of a company suffer its indebtedness to exceed the amount of its capital stock actually paid in. A stockholder in the course of trade becomes a creditor of the company. He may, under a statute making the directors liable to pay the debts of the company, when such indebtedness during their administration shall exceed the amount of its capital stock actually paid in,[3] recover such indebtedness of the directors.[4] But where the debt arises in consequence of the stockholder being compelled to *contribute* to pay a debt so illegally contracted by the directors, the rule is different. The statute was not intended to give such an action against directors in favor of stockholders when they seek to enforce a demand arising in their favor as stockholders; it was for the protection of creditors and not stockholders; and stockholders can only avail themselves of it when they appear as creditors, claiming payment of debts arising in their favor from the corporation, in the ordinary course of dealing, and not growing out of their relation as stockholders.[5] In like manner, the New Jersey statute "to authorize the establishment and to prescribe the duties of companies for manufacturing and other purposes," does not create a personal liability against individual directors, for the debts of the corporation, at the suit of the stockholder as such. Nor will a charge of usurpation of office and destruction of corporate property by indi-

[1] *Ante*, § 1071, *et seq.; post*, § 4460.

[2] Sanborn *v.* Lefferts, 16 Abb. Pr. (N. S.) (N. Y.) 42.

[3] Gen. Stats. Mo. 1855, p. 374, § 20.

[4] Anderson *v.* Blattau, 43 Mo. 42; distinguishing Kritzer *v.* Woodson, 19 Mo. 327, as stated in the text.

[5] This conclusion is the result of a comparison of Kritzer *v.* Woodson, 19 Mo. 327, and Anderson *v.* Blattau, 43 Mo. 42.

vidual directors entitle a stockholder to maintain an action under the act. The liability in the first case is to creditors alone, and so it is in the second case, if there be any liability at all.[1] A statute which makes the directors of a bank liable for certain official defaults, *to any creditor* of the corporation, makes them liable to a stockholder, provided he becomes a creditor. If, therefore, a stockholder redeems bills of the bank, he may bring an action against the directors to enforce this statutory liability.[2] But where the directors of a corporation commit breaches of duty by reason of which, under a statute, they become liable to the stockholders, it does not make them liable to one who purchased his stock *after* the commission of such breaches of duty. The case is like that of a man who purchases a horse which has been injured by a third person in the hands of the seller. This does not give him a right of action against the person doing the injury.[3]

§ 4326. Actions by Attorney-general in New York. —By a very peculiar statute of New York, the attorney-general is required to bring actions to redress *breaches* of trust committed by directors of private corporations.[4]

§ 4327. Judgment against Corporation a Condition Precedent. — By the analogy of cases which relate to the liability of shareholders[5] who are not directors, it would seem clear, in the absence of anything in the statutes importing the contrary,[6] that a creditor could not proceed against the officers of a corporation without first having obtained a judgment against

[1] Riegel *v.* Rinehart, 26 N. J. Eq. 219.

[2] Robinson *v.* Bealle, 20 Ga. 275, 295.

[3] Mabey *v.* Adams, 3 Bosw. (N. Y.) 346.

[4] N. Y. Code Civ. Proc., §§ 1781, 1782, 1808, 1810. See People *v.* Bruff, 60 How. Pr. (N. Y.) 1, where such an intervention was successful; also People *v.* Ballard, 3 N. Y. Supp. 845; *s. c.* 29 N. Y. St. Rep. 926; 8 N. Y. Supp. 918, — where the court rule, in seeming opposition to the language of the statute, that the action cannot be maintained where only *private* interests are involved.

[5] *Ante*, § 3354, *et seq.*; Blake *v.* Hinkle, 10 Yerg. (Tenn.) 218, 220; Drinkwater *v.* Portland &c. Ry., 18 Me. 35.

[6] Cambridge Water Works *v.* Somerville Dyeing Co., 4 Allen (Mass.), 239.

the corporation. This would seem to be true for stronger reasons than in the case of stockholders; for the liability of the directors is like that of a surety, *stricti juris*, and obviously ought not to attach so long as the debt can be made out of the company. And so it has been held, under a statute charging the directors of insurance companies with liability for losses on policies issued after the company was under a liability to an amount equal to its capital stock.[1] This view is supported by a case in Tennessee, which turned upon the construction of the terms of the charter of the bank of East Tennessee, a private statute, not accessible to the writer, and not set out, as it ought to have been, in the report of the case. It appears to have provided, however, that directors of the bank, who should sanction certain violations of its charter, might be held liable in their individual capacities for any loss or damages which might thereby happen to the creditors of the bank. It was held that two things must exist as conditions precedent to the enforcement of this liability: 1. The violations of the charter must have been established by some direct proceeding against the corporation, although it was held not necessary that such proceeding should have resulted in a forfeiture of the charter; 2. That the assets of the corporation itself must have been first exhausted. The measure of the liability of the directors, then, would be the amount which its assets might fall short of discharging its liabilities which had accrued in consequence of such violations of the charter.[2] So, under a statute of Massachusetts now in force,[3] a judgment must be recovered against the corporation and an execution returned thereon unsatisfied, after which any creditor may file a bill in equity, for himself and all the other creditors, against all the officers liable for the debts of the corporation; and in such proceedings the judgment creditor filing the bill, as well as other creditors, may prove any claims due on *simple con-*

[1] Kinsley *v.* Rice, 10 Gray (Mass.), 325.

[2] Johnson *v.* Churcwell, 1 Head (Tenn.), 146. See also Bird *v.* Hayden, 1 Robt. (N. Y.) 383; 2 Abb. Pr. (N. Y.) 61.

[3] Pub. Stat. Mass., ch. 106, §§ 62, 64.

tract.[1] So, under a statute of New York,[2] a judgment creditor only can maintain an action against directors for their misconduct.[3] And this rule is established in many cases *by statute.*[4]

§ **4328. Exception in Case of Inchoate Corporations.** — An obvious exception to this principle exists in those cases where directors of *inchoate* or pretended corporations are proceeded against for debts contracted by them in the name of a corporation, when there is really no corporation in existence. In such a case there would be no sense in requiring the creditor to obtain a judgment against the so-called corporation before proceeding against the persons with whom he made the contract.[5]

§ **4329. Exception in Some States.** — In Minnesota, it is not necessary that the creditor, before suing the directors, shall have obtained judgment against the corporation. He may, if necessary, join it as a co-defendant with the directors, and establish his claim against the corporation in the same action.[6] The statute of New York relating to manufacturing corporations, which provides that "every director shall be personally liable for all the debts incurred by the corporation, to an amount not exceeding $5,000," is held to impose on the directors an original contract liability, without regard to the efforts of the creditor to collect his demand from the corporation.[7]

[1] Thacher *v.* King, 156 Mass. 490; *s. c.* 31 N. E. Rep. 648. The court also intimate that when the condition named in the statute exists, namely, a judgment against the corporation and an execution returned *nulla bona*, any creditor, whether he be a judgment creditor or not, can file the bill.

[2] Civ. Code N. Y., §§ 1781, 1782.

[3] Paulsen *v.* Van Steenbergh, 65 How. Pr. (N. Y.) 342.

[4] Supp. to Gen. Stats. Mass., vol. I., p. 811, § 40; Rev. Stats. N. J. 1877, p. 194, § 96; 2 Bright. Purd. Dig. Pa. 1873, p. 1411, § 47; Bangs *v.* Lincoln, 10 Gray (Mass.), 600, 605; Thayer *v.* Union Tool Co., 4 Gray (Mass.), 75; Denny *v.* Richardson, 4 Gray (Mass.), 274; Norfolk *v.* American Steam Gas Co., 103 Mass. 160; Cambridge &c. *v.* Somerville &c. Co., 4 Allen (Mass.), 239; Kinsley *v.* Rice, 10 Gray (Mass.), 325. Compare Merchants' Bank *v.* Stevenson, 5 Allen (Mass.), 398.

[5] *Ante,* §§ 416, 4218.

[6] Patterson *v.* Stewart, 41 Minn. 84; *s. c.* 16 Am. St. Rep. 671; 42 N. W. Rep. 926.

[7] State Bank *v.* Andrews, 18 N. Y. Supp. 167. Compare *ante,* § 3077.

§ 4330. Theory that Judgment against Corporation is Conclusive. — Under a statutory system, like that of Massachusetts,[1] where the creditor is obliged, before he can proceed against the directors, to exhaust his remedy at law, so to speak, by recovering a judgment against the corporation, and having an execution thereunder returned *nulla bona*, it is analogous to the rule relating to the creditor's bills in equity, to hold that the judgment against the corporation is conclusive against the directors, of the amount which the plaintiff is entitled to recover of them; and such is the rule in Massachusetts.[2] But it should seem that, under any sufficient remedial system, the directors ought to be allowed, by way of an equitable defense to the action against them, to impeach the judgment obtained against the corporation, on the ground of fraud or collusion. On the other hand, even under a system discussed in the next section, where a judgment obtained by a creditor against the corporation is not even *prima facie* evidence in such an action against the directors, it has been held that it is *conclusive in their favor;* so that they may show, as a complete defense, that the plaintiff brought an action against the corporation to recover the same debt, and that judgment was rendered in favor of the corporation on the merits.[3] But this decision seems to be unsound; because it is a rule that *estoppels are mutual*, and it is difficult to understand a principle on which a judgment is or is not to conclude the re-litigation of the same matter in another action, accordingly as it was rendered for one party or the other.

§ 4331. Theory that Such Judgment not Evidence against the Directors. — The rule established under the New York statutes is that a judgment against the corporation in favor of the creditor is not only not conclusive,[4] but that it is not even *prima facie* evidence in such an action against a director, — in other words that a judgment-roll *is not admissible in evi-*

[1] *Ante*, § 4311.

[2] Thayer *v.* New England Lith. &c. Co., 108 Mass. 523.

[3] Tyng *v.* Clarke, 9 Hun (N. Y.), 269.

[4] Kraft *v.* Coykendall, 34 Hun (N.Y.), 285.

dence for the purpose of proving the existence of the "debt" for which by the terms of the statute the directors may become liable.[1] The theory of these holdings seems to be that it does not follow, from the fact that the creditor must exhaust his remedy against the corporation before he can charge the directors, that his judgment against the former will be *prima facie* evidence against the latter; that a reasonable conclusion, from the rule that statutes of this nature are penal, and hence to be strictly construed and applied, is that the debt against the corporation, for the payment of which the directors will be personally charged, in consequence of the particular violation of duty enjoined by the statute, must be established in a direct proceeding against the directors; and that there is no such privity between the directors and the corporation as will make a judgment recovered against the corporation *prima facie* evidence of the validity of the debt in a proceeding to charge the directors under such a statute.[2] But while the courts of that State seek to justify this conclusion upon general grounds, it can, perhaps, be supported on no other ground than that proceedings of this kind against directors of a corporation to charge them with a debt not their own, are *stricti juris*. This conclusion conforms to the peculiar doctrine of the courts of that State in respect to the liability of stockholders. Under the statutes of that State making the *stockholders* of corporations liable in certain cases for the payment of the debts of the corporation, the courts hold, after a considerable conflict of opinion, that the judgment obtained by the creditor against the corporation is not even *prima facie* evidence of his debt against the stockholder.[3] They accordingly hold that an action against a

[1] Chase *v.* Curtis, 113 U. S. 452; Brandt *v.* Godwin, 3 N. Y. St. Rep. 807; *s. c.* 8 N. Y. Supp. 339; Esmond *v.* Bullard, 16 Hun (N. Y.), 65, and other cases cited below.

[2] Miller *v.* White, 50 N. Y. 137 (reversing *s. c.* 57 Barb. (N.Y.) 504, and 59 Barb. (N. Y.) 434); Rorke *v.* Thomas, 56 N. Y. 559; McHarg *v.* Eastman, 35 How. Pr. (N. Y.) 205; *s. c.* 7 Robt. (N. Y.) 137; Esmond *v.* Bullard, 16 Hun (N. Y.), 65. These decisions overrule Hall *v.* Siegel, 7 Lans. (N. Y.) 206.

[3] See McMahon *v.* Macy, 51 N. Y. 155, 162, and particularly the opinion of Mr. Commissioner Gray, where the previous authorities on the subject are reviewed.

stockholder to charge him for a debt of the corporation is on the *original demand*, and not on the judgment which the plaintiff has obtained against the corporation.[1] This being so, the burden of establishing the validity of the debt is upon the plaintiff, and he must make out his case.[2] In respect of the liability of stockholders, a contrary rule prevails in other States.[3]

§ 4332. Whether Judgment against Corporation by Garnishment a Sufficient Foundation for Such an Action. — If a voluntary assignment by a creditor, of his debt against the corporation, carries with it his statutory remedy against the directors,[4] an *involuntary assignment* of it, such as takes place by the judgment of a court in a proceeding by *garnishment*, as it is called in most of the States, or by *trustee process*, as they say in Massachusetts, or by *factorizing*, as they call it in Connecticut, should have the same effect. This has been held in Massachusetts,[5] but denied in Connecticut.[6] Thus, A. sues B., and recovers a judgment against him. C., a corporation, is at the same time in debt to B. A. proceeds against the corporation by garnishment, as we would say, or by *scire facias*, according to the terms used in Massachusetts, and charges the corporation as trustee — that is, gets a judgment against it as garnishee. The corporation becomes insolvent, and this judgment cannot be made out of the corporate assets. Suppose now, that the officers of the corporation have neglected to file a certificate required by a statute, so that, by the terms of the statute, they have made themselves liable to pay the

[1] Moss *v.* McCullough, 5 Hill (N. Y.), 131; Moss *v.* Averell, 10 N. Y. 449; Belmont *v.* Coleman, 21 N. Y. 96; Conant *v.* Van Schaick, 24 Barb. (N. Y.) 87. For conflicting decisions, see Moss *v.* Oakley, 2 Hill (N. Y.), 265; Belmont *v.* Coleman, 1 Bosw. (N. Y.) 188; Slee *v.* Bloom, 20 Johns. (N. Y.) 669; *s. c.* 10 Am. Dec. 273.

[2] Dabney *v.* Stevens, 40 How. Pr. (N. Y.) 341.

[3] Merrill *v.* Suffolk Bank, 31 Me. 57; *s.c.* 50 Am. Dec. 649; Came *v.* Brigham, 39 Me. 35; Milliken *v.* Whitehouse, 49 Me. 527, 529; Donworth *v.* Coolbaugh, 5 Iowa, 300; Wilson *v.* Pittsburgh &c. Coal Co., 43 Pa. St. 424; Grund *v.* Tucker, 5 Kan. 70; Hawes *v.* Anglo-Saxon Co., 101 Mass. 385, 397.

[4] *Ante*, § 4190. Compare *ante*, § 3556.

[5] Norfolk *v.* American Steam Gas Co., 103 Mass. 160.

[6] Armstrong *v.* Cowles, 44 Conn. 44.

corporate debt. Suppose, moreover, another statute enacts that no officers of a corporation shall be held liable for any debts or contracts of the corporation, "unless a judgment is recovered against it, and the corporation shall neglect for the space of thirty days after demand to pay the same," etc. Under these circumstances, can the officers be made liable? It has been held that they can. A judgment on "trustee process" was deemed a judgment within the language just quoted.[1] On the contrary, in Connecticut, the judgment against the corporation on the *scire facias* (the process made use of in Connecticut), was not "a debt contracted" during the time of the default of the directors, so as to come within the statute making the directors liable for the debts of the company.[2]

§ **4333. Burden of Proof under Such Statutes.**—Such statutes being penal in their nature,[3] the rule applies with more than the usual force that the burden of proof is upon the party seeking to recover under them. Nothing can be presumed against the defendant, and every fact necessary to establish his liability must be affirmatively proved. And whilst, even in criminal proceedings, the burden rests sometimes upon the defendant, in consequence of the impossibility of the prosecution proving a negative,[4] yet, here it has been held that every fact necessary to make out the plaintiff's case must be proved by him, even though it can only be done by

[1] Norfolk *v.* American Steam Gas Co., 103 Mass. 160. In this case A. sued B. in "trustee process," and summoned a manufacturing corporation as his trustee. Pending this suit, B. sued the corporation on the debt owing to him; the action was referred to arbitrators, and an award was returned for B., to which the corporation made no objection as to its liability in trustee process. A. recovered judgment against B. and the trustee, and afterwards against the trustee in the *scire facias*. In B.'s action, by agreement of parties, he took judgment for costs only. Upon the failure of the corporation to satisfy its judgment, after due proceedings under the statute of 1862, ch. 218, A. and B. joined in a bill in equity to charge its officers with personal liability thereon. It was held that they were entitled to recover the amount of the judgment, excluding costs, in the *scire facias;* and also to recover costs in the suit in equity.

[2] Armstrong *v.* Cowles, 44 Conn. 44.

[3] *Ante*, § 4164.

[4] See, however, Whart. on Ev., § 356.

proving a negative. When, therefore, in such an action, the issue was whether a certain report had been made, filed, and published, as required by the statute, it was held not incumbent upon the defendant to prove the publication of it; it was for the plaintiff to show that it had not been published.[1] But in a case in Michigan, where the statute made directors liable for an intentional neglect to file certain reports, it was held that, in the absence of any proof to the contrary, it would be presumed that a failure was intentional.[2]

§ 4334. Parol Evidence Admissible to Identify the Judgment. — In a bill in equity, or in any other supplementary proceeding against the officers of a corporation, *founded on a judgment at law against the corporation*, as under the procedure in Massachusetts,[3] the record of judgment will not show at what time the debt for which it was recovered was contracted. If, then, the liability of the officers rests upon the fact that the debt sued for was contracted during the period of a certain official default, how shall this be shown? This is only one of many cases where it is necessary to resort to parol evidence to ascertain what facts were settled by a verdict or a judgment. The rule is said to be, that if this does not appear by the record, or that if the verdict may have been based upon one of several grounds, it is competent to show by parol evidence what facts were passed upon by the jury.[4] Applying this principle, it has been held that parol evidence is admissible to show that the judgment obtained against the corporation was founded upon a debt contracted during a period when the officers were in default in the filing of certain records required by a statute.[5]

§ 4335. Misjoinder of Such Causes of Action. — An action for such a statutory penalty cannot be joined with an action

[1] Whitney Arms Co. *v.* Barlow, 68 N. Y. 34; *s. c.* 63 N. Y. 62; 20 Am. Rep. 504.

[2] Van Etten *v.* Eaton, 19 Mich. 187. See, however, Breitung *v.* Lindauer, 37 Mich. 217.

[3] *Ante*, § 4311.

[4] Burlen *v.* Shannon, 14 Gray (Mass.), 433, and cases there cited; *s. c.* 99 Mass. 200; 96 Am. Dec. 733; Merritt *v.* Morse, 108 Mass. 270.

[5] Norfolk *v.* American Steam Gas Co., 108 Mass. 404.

under another statutory provision, making the *shareholders* of a corporation personally liable for the debts of the corporation because of a failure to make and record a certificate of incorporation; because this latter action would be an action upon a contract.[1] But, under the provisions of the New York Code of Procedure, section 167, authorizing the joinder of causes of action which arise out of the *same transaction*, or transactions connected with the *same subject of action*, in an action to charge the officers of a corporation, individually, for a debt of the corporation, a cause of action, for *not making the annual report* within the twenty days prescribed by law, may be *joined* with a *cause of action* for *making a false report*, though both refer to the same year.[2] But if such false report was not signed by *all the defendants* who are charged with omission to make report, there is a *misjoinder* of actions, by reason that the distinct causes of action do not affect all the defendants.[3]

§ 4336. Pleading under Such Statutes: Complaint must Allege All the Statutory Grounds of Recovery. — In pleading upon a statute, the general rule obtains that the declaration must contain allegations embracing all the material elements of the statute.[4] And whilst it will be sufficient if the words of the statute are followed,[5] yet it is in all cases necessary to follow its terms, either in words or in substance. This rule obviously applies with more strictness where the statute is in its nature penal, than in other cases. When, therefore, a statute rendered officers of a corporation liable to pay the debts of the corporation for certain non-feasances, but only in case of neglect or refusal, for thirty days after a written request by a creditor or stockholder, to perform the duty imposed, a demurrer to a bill in equity to enforce the liability of the statute was sustained, because the bill failed to allege

[1] Wiles *v.* Suydam, 64 N. Y. 173; Napier *v.* Mortimer, 11 Abb. Pr. (N. S.) (N. Y.) 455.

[2] Bonnell *v.* Wheeler, 16 Abb. Pr. (N. S.) (N. Y.) 81.

[3] *Ibid.* See also Sterne *v.* Hermann, 11 Abb. Pr. (N. S.) (N. Y.) 376; Vincent *v.* Sands, 11 Abb. Pr. (N. S.) (N.Y.) 231.

[4] Henniker *v.* Contocook Valley R. R., 29 N. H. 146.

[5] Gunter *v.* Dale County, 44 Ala. 639.

that a written request to perform the duty had been made.[1] So, a complaint in an action to enforce the liability of defendants as trustees of a corporation, for a neglect to file the annual report as required by the New York Manufacturing Companies Act, plaintiff being at the time a creditor of such corporation on account of *services* rendered, must allege that such services were rendered *at the request* of the corporation.[2] So, the complaint, in such an action, is bad on demurrer, if it fails to aver those things which the statute makes the foundation of the liability, — as, for example, that the corporation did business in the county.[3] Such a complaint must state the purpose for which the corporation was organized (merely filing a copy of its articles of association is not enough), and also that the defendants constitute a majority of the directors, or it will be demurrable.[4] In such an action it is not necessary to *file a copy of the articles* of association of the corporation, because that is not the foundation of the action.[5]

§ **4337. What Exceptions of the Statute must be Negatived.** — It is an old rule that in declaring on such statutes, any exception contained in the enacting or prohibiting clause of the statute must be excluded by averment.[6] But an excep-

[1] Nassau Bank *v.* Brown, 30 N. J. Eq. 478.

[2] Tovey *v.* Culver, 54 N. Y. Super. Ct. 404. As to the requisites of the petition in an action under the Iowa Revision, § 1163, against an officer or stockholder of a corporation for fraud, etc., see White *v.* Hosford, 37 Iowa, 566.

[3] Anfenger *v.* Anzeiger Pub. Co., 9 Colo. 377.

[4] Niles *v.* Dodge, 70 Ind. 147. That the allegation that the defendants were *stockholders* is not irrelevant, see Sterne *v.* Herman, 11 Abb. Pr. (N. S.) (N. Y.) 376. For the allegations in a bill in equity under Mass. Stat. 1862, ch. 218, to charge officers of a manufacturing corporation personally with a debt thereof, — see Norfolk *v.* American &c. Co., 108 Mass. 404; Thayer *v.* New England Lith. &c. Co., 108 Mass. 523. For a bill in equity which failed to show that the excess of debts over and above the amount of capital stock actually paid in, happened under the administration of the defendants, see Merchants' Bank *v.* Stevenson, 5 Allen (Mass.), 398.

[5] Niles *v.* Dodge, 70 Ind. 147.

[6] Gould's Pl., ch. 4, § 22. This has been held where the statute was not penal. Chicago &c. R. Co. *v.* Carter, 20 Ill. 390; Ohio &c. R. Co. *v.* Brown, 23 Ill. 94; Galena &c. R. Co. *v.* Sumner, 24 Ill. 631; Great Western R. Co. *v.* Bacon, 30 Ill. 347; *s. c.* 83 Am. Dec. 199; Toledo &c. R. Co. *v.* Lavery,

tion contained in any clause of the statute is matter of defense properly to be pleaded and proved by the defendant.[1]

§ **4338. Averment of Date of Debt.** — An action on a statute, making trustees of corporations liable to pay the debts of the company, contracted while they were in default as to the filing of certain *annual reports*,[2] must, on grounds apparent from what has already been seen,[3] aver that the debt was *existing at the time* the default was made by the trustees, or show that it was contracted afterwards, or it will be defective.[4] So, in a suit to charge a trustee with the debt of a corporation because of the filing of a *false report*, and allowing the indebtedness to exceed the capital stock, the complaint is defective in failing to allege that the debt was contracted *after* the defendant became trustee.[5] So, a bill in equity under the statute of Wisconsin[6] does not state a right of recovery when it merely alleges that the directors refused to make a *certificate*, signed by the president and secretary in either of the months of July or January following the organization of said company, etc.; but it should be further alleged that the indebtedness to the plaintiff was contracted *after such refusal*, and before the making of any subsequent annual statement.[7] An allegation that the defendant was, January 13, 1877, and "before that date," a trustee, is not a good averment that he was such trustee in the year 1876, when the debt was alleged to be contracted.[8]

§ **4339. Averment that the Debt Remains Unpaid.** — It has also been ruled, but the ruling seems highly technical, that it is not sufficient to allege that judgment was recovered on the debt against the corporation (for the payment of which the

71 Ill. 522; Great Western R. Co. *v.* Hanks, 36 Ill. 281; Illinois &c. R. Co. *v.* Williams, 27 Ill. 48.

[1] Gould's Pl., ch. 4, § 22; Chicago &c. R. Co. *v.* Carter, 20 Ill. 390; Toledo &c. R. Co. *v.* Lavery, 71 Ill. 552.

[2] *Ante*, § 4221, *et seq.*

[3] *Ante*, § 4206.

[4] McHarg *v.* Eastman, 7 Robt. (N. Y.) 137; *s. c.* 35 How. Pr. (N. Y.) 205.

[5] Anderson *v.* Speers, 8 Abb. N. Cas. (N. Y.) 382.

[6] Rev. Stats. Wis., ch. 73, § 23.

[7] Seaman *v.* Goodnow, 20 Wis. 27.

[8] Anderson *v.* Speers, 58 How. Pr. (N. Y.) 68.

trustees, if liable at all, were liable), *and that such judgment remains unsatisfied*, but it must be alleged *that the debt remains unpaid*. The reason given was that whether the amount claimed was due upon the judgment or for the debt, or upon the defendant's liability as trustees or otherwise, did not appear.[1]

§ **4340. Misdescription of the Statute Immaterial.** — It is a familiar rule, that a public statute need not be recited or even referred to in pleading. It is sufficient if the pleader states a case which is within it.[2] This being so, if, in the pleading, the statute is erroneously referred to, as where, by a clerical mistake, the draughtsman refers to the wrong section of the statute, the error will be rejected as surplusage.[3]

§ **4341. Not Necessary to Aver how the Damage Happened.** — Under a statute prohibiting the doing of certain acts by the directors of moneyed corporations, and in case of their doing them, making them "liable personally to the creditors and stockholders respectively of the corporation, ... to the full extent of any *loss* they may respectively sustain from such violation," it is sufficient that a stockholder, in his declaration, after stating the illegal act, allege that thereby the *plaintiff's stock became depreciated* and of less value than it otherwise would have been, and that the plaintiff thereby, and in consequence of such violation of the act, lost a large sum of money, to wit, the sum of $500. It is not necessary to show *how or in what manner* the defendant's illegal act caused the depreciation of the plaintiff's stock, because that would be matter of *evidence*. It is enough that the fact of depreciation is directly alleged.[4] A statute existed in Vermont, providing that no individual should be

[1] McHarg *v.* Eastman, 7 Robt. (N. Y.) 137; *s. c.* 35 How. Pr. (N. Y.) 205. Compare Chambers *v.* Lewis, 28 N. Y. 454.

[2] Buell *v.* Warner, 33 Vt. 570, 578.

[3] McHarg *v.* Eastman, 7 Robt. (N. Y.) 137; *s. c.* 35 How. Pr. (N. Y.) 205.

[4] Gaffney *v.* Colvill, 6 Hill (N. Y.), 567, 574. Compare *ante*, § 1430, *et seq.*, as to particularity in pleading fraud.

directly or indirectly indebted to a greater amount than ten per cent to any bank, with exceptions as to deposits made for redeeming, and as to purchases of bills of exchange. Another provision of the statute made directors liable to creditors and stockholders for all loss which the bank might sustain through any violation by them of the banking laws of the State. In the case of Buell *v.* Warner,[1] there will be found a declaration under this statute set out in full, to which a number of specific objections were taken by special demurrer; but it was, nevertheless, held good. But another court has held, in an action to charge directors for failing to make a statutory report of the financial condition of the corporation, that the *manner* in which the plaintiff was misled and deceived must be charged with reasonable fullness and certainty.[2]

§ **4342. Other Points in Such Complaints.** — Under a statute prohibiting the *doing* of certain acts by directors, a declaration, which alleges that they *caused* them to be done, has been held bad on special demurrer; but it seems that if the declaration alleged that the directors *did* the prohibited acts, it would be sustained by evidence that they caused them to be done — the reason of the rule being that more particularity is required in matters of pleading than in matters of evidence.[3] Notwithstanding these statutes are construed strictly, it has been held that where a statute prohibits the doing of certain acts by directors in positive terms and says nothing about a *scienter*, it is not necessary, in declaring on the statute, to allege that they did the acts *knowingly*. If mistake or want of guilty knowledge is a defense, it is for the defendant so to excuse himself.[4] It is not a good objection on account of *duplicity* that the declaration on such a statute allege that the directors did divide, withdraw, and pay to the

[1] 33 Vt. 570.

[2] For a complaint where it was not charged with sufficient certainty, see Niles *v.* Dodge, 70 Ind. 147.

[3] Gaffney *v.* Colvill, 6 Hill (N. Y.), 567, 574.

[4] *Ibid.*

stockholders a portion of the capital stock of the company, and did *thereby reduce* the capital stock without the consent of the Legislature; for a pleading is not double because it states the effect of the act complained of, nor because several words or phrases are used to express the same thing.[1]

§ 4343. Plaintiff Recovers upon a Preponderance of Evidence. — It has been held, in an action prosecuted against the directors of a corporation to render them personally liable for *falsely certifying* that the full amount of their capital stock has been paid in, to charge the jury that the plaintiff, in order to recover, should satisfy them of the guilt of the defendants beyond a *reasonable doubt;* but they should be permitted to reach a conclusion upon the rule which obtains in civil cases of a fair *preponderance of evidence.*[2]

§ 4344. Procedure in Case of the Death of a Director. — It is a rule of the *common law,* that the personal representative of a deceased joint obligor cannot be joined in an action against the survivor.[3] This rule has been applied in Massachusetts, so as to exempt the estate of a deceased shareholder from liability as such, unless his personal representative should choose to come forward and assume such liability, by paying claims or otherwise.[4] This unjust and mischievous rule has been changed by statute in most of the States, it is believed. Thus, in Georgia, it was early enacted that a creditor should not, in such a case, "be compelled to sue the survivor alone," but might, "at his discretion, sue the survivor or the representatives of the deceased person, or the survivor in the same action with the representatives of the deceased person."[5] Under this statute, if some of the directors, guilty

[1] Gaffney *v.* Colvill, 6 Hill (N. Y.), 567, 574. *Answer upon information and belief* insufficient: 19 Am. & Eng. Corp. Cas. 112, n.

[2] Huntington *v.* Attrill, 118 N. Y. 365; *s. c.* 23 N. E. Rep. 544; 29 N. Y. St. Rep. 5.

[3] Green *v.* Watkins, 6 Wheat. (U. S.) 260.

[4] Dane *v.* Dane Man. Co., 14 Gray (Mass.), 488; Ripley *v.* Sampson, 10 Pick. (Mass.) 371; Child *v.* Coffin, 17 Mass. 64.

[5] Cobb Ga. Stat. 483.

of a statutory default, should die before the commencement of the suit, the plaintiff was not bound to join their representatives in the suit, though he might do so.[1] But *in equity*, the maxim *actio personalis moritur cum persona* does not obtain, and therefore the liability of directors to creditors, founded in fraud, may be redressed in those tribunals by an action against their personal representatives in case of their death.[2]

§ 4345. Rule in Massachusetts in Case of Insolvency Proceedings against Director. — It has been held in Massachusetts that the qualified liability of a member of a manufacturing corporation, for the debts of the corporation, under an old statute,[3] was not a "debt" such as could be proved in a court of insolvency against the estate of the deceased shareholder, under a statute defining the demands which might be proved as "all *debts* due and payable from such debtor."[4] This statute, it may be observed, made the members of corporations liable as original contractors, and execution ran against them on judgments against the corporation, without their having any day in court. This statute was held not to authorize execution against estates of shareholders who died before the commencement of suit against the corporation;[5] nor did it make the debts of the corporation a charge upon the estates of deceased shareholders;[6] nor could one shareholder, who had voluntarily paid a debt of the company, have contribution against another.[7] As late as 1860, the same court held that where a stockholder, who had been summoned, pursuant to the statute, to charge him with a debt of the corporation, died, the suit abated and could not be revived against his executor.[8] Pursuing, apparently, the same general lines of construction, the same court has held that the liability of the officers of corporations to pay the debts of the corporation, on account of certain official defaults, is not a debt provable against the estate of such an officer in insolvency. The reasoning on which the court

[1] Hargroves *v.* Chambers, 30 Ga. 580, 588.

[2] Schley *v.* Dixon, 24 Ga. 273, 279; *s. c.* 71 Am. Dec. 121.

[3] Act of 1808, ch. 65, § 6.

[4] Kelton *v.* Phillips, 3 Met. (Mass.) 61.

[5] Child *v.* Coffin, 17 Mass. 64.

[6] Ripley *v.* Sampson, 10 Pick. (Mass.) 371. The contrary was held under a later statute. Grew *v.* Breed, 10 Met. (Mass.) 569, 576.

[7] Andrews *v.* Callender, 13 Pick. (Mass.) 484.

[8] Dane *v.* Dane Man. Co., 14 Gray (Mass.), 488.

proceeded was, that such debts are not absolute debts, and that it would produce great confusion and delay in the settlement of the estates of insolvents, if they should be allowed to be proved and paid among other debts.[1] Under the revised statutes,[2] the only remedy against directors, for contracting corporate debts in excess of the capital stock, was by a bill in equity, provided the debts for which the directors were so liable amounted to more than such excess.[3]

§ 4346. Other Decisions under Statutes of Massachusetts. — A number of successive statutes have been enacted in Massachusetts, making directors of corporations personally liable for the debts of the corporation, under various circumstances and for various official defaults. The statutes have been construed by the Supreme Judicial Court of that State with reference to a number of questions which have been raised with regard to their interpretation in points which are not of a general character, so that such decisions do not much aid in the interpretation of other like statutes in other States. The results reached in these cases may be here briefly collected and stated. The Act of 1851[4] forbade the property of the general stockholders in corporations to be taken in execution for the corporate debts while there were officers liable, and upon whose property execution could be levied. This statute applied to executions which were issued upon debts which were payable before the act took effect.[5] By the practice which obtained in that State in 1858, when a manufacturing corporation was sued, its stockholders were summoned in, and if the execution could not be satisfied out of the corporate property, it ran against the stockholders personally. With the foregoing statute in force, a stockholder was summoned in, and the corporation having made default, he answered that he was not liable for the corporate debts as a stockholder, "because, if the stockholders thereof are liable for the debts of the corporation, their persons or property cannot be taken so long as the officers thereof have property sufficient to satisfy the execution, if any, which the plaintiff may obtain; and there are officers of said corporation hav-

[1] Bangs *v.* Lincoln, 10 Gray (Mass.), 600.

[2] Rev. Stats. Mass., ch. 38, §§ 25, 29, 31.

[3] Merchants' Bank *v.* Stevenson, 10 Gray (Mass.), 232.

[4] Ch. 315, § 3.

[5] Denny *v.* Richardson, 4 Gray (Mass.), 274.

ing sufficient property to pay said claim." This answer was held bad on demurrer; for the material question was, not whether the officers were possessed of sufficient property to pay the debt when the action was pending in court, but when the execution was to be levied.[1] The statute of 1851[2] did not authorize the levying of an execution issued on a judgment recovered against a manufacturing corporation, on the property of an officer of the corporation, unless, if he was also a stockholder, he had been summoned and his liability established; or, unless, if he was not a stockholder, some stockholder had been summoned and the liability of the stockholders established, in the action in which the judgment was recovered.[3] A *supersedeas* annexed to an execution issued on a judgment against a manufacturing corporation, as to certain stockholders who had been summoned in the action in which the judgment was recovered, pursuant to section 2 of the above act, did not exonerate such stockholders from any liability *as officers* of the corporation. Nor did such execution and *supersedeas* afford protection to an officer against another stockholder, upon whose property he levies the execution, when there are such persons, liable as officers, and having property upon which the execution might be levied.[4] A mining corporation is not a manufacturing corporation within the statute, 1862, chapter 218, defining and regulating the enforcement of liabilities of officers and stockholders of manufacturing corporations.[5] A bill in equity under the last-named statute must be brought in behalf of *all the creditors* of a corporation.[6]

§ 4347. Costs in Proceedings under These Statutes.— Recollecting that statutes of the class we are considering are to be strictly construed, we are prepared to find that the courts hold that a statute which, on account of certain defaults, makes the directors liable for all debts of the company then existing, does not make them liable for the costs in

[1] Brayton *v.* New England Coal Mining Co., 11 Gray (Mass.), 493.

[2] Ch. 315, § 3.

[3] Dewey *v.* Baker, 16 Gray (Mass.), 130.

[4] *Ibid.*

[5] Byers *v.* Franklin Coal Co., 106 Mass. 131.

[6] Moore *v.* Reynolds, 109 Mass. 473. The personal liability of the directors of a corporation, imposed by Mass. Stat. 1870, ch. 224, § 38, is not affected by that of 1877, ch. 230, § 1. First Nat. Bank *v.* Hingham Man. Co., 127 Mass. 563.

the suit against the company by which the plaintiff's debt was established,[1] though of course they will be liable for the costs which may accrue in the direct proceeding against themselves to enforce this penalty.[2]

§ 4348. Various Matters of Practice in Such Actions.— To authorize a judgment against the directors under statutes of this kind, process must be issued and served upon them personally—in other words, a separate action must be prosecuted against them. So held under a special charter,[3] but this would undoubtedly be the rule under any of the statutes considered in this chapter. It has been held in Pennsylvania that a return of *nulla bona* merely is not a sufficient foundation for a bill in equity to charge the officers of certain corporations, under a statute, with the debts of the corporation. The return must set out that no real or personal property of the corporation was exhibited to the officer, sufficient to satisfy the debt, as required by the act.[4] When an action against a corporation was prosecuted under a writ commanding the body of a certain named director to be taken, it was held untenable to argue, after a judgment against the company and an appeal taken by it, that the suit was against the director and not against the corporation;[5] since the appearance cured any defect in the process.

Article XII. Defenses to Such Actions.

SECTION
4354. Defense of no corporation.
4355. When this defense available.
4356. Defense of negligence, ignorance of law, want of guilty *scienter*.

[1] Rorke *v.* Thomas, 56 N. Y. 559. For the rule as to stockholders, see Thomp. Stockh., § 375.

[2] Thus, the directors of a corporation, against which judgment of *ouster* has been pronounced, are individually answerable for the *costs* of the proceeding, though they had no direct agency in defending the suit. People *v.* Ballou, 12 Wend. (N. Y.) 277.

[3] Cunningham *v.* Pell, 5 Paige (N. Y.), 607.

[4] Bacon *v.* Morris, 10 Phila. (Pa.) 93.

[5] Aycock *v.* W. & W. R. Co., 6 Jones L. (N. C.) 231. *Nominal defendant* in action against English *joint-stock company:* Wormwell *v.* Hailstone, 6 Bing. 668; *s. c.* 4 Moore & P. 512; Harrison *v.* Timmins, 4 Mees. & W. 510; Bartlett *v.* Pentland, 1 Barn. & Ad. 704.

SECTION
4357. Statutes creating a presumption of assent.
4358. Director exonerated by resigning or abandoning the office.
4359. Other evidence of want of assent.
4360. Assent of the plaintiff to the prohibited act.
4361. Defense of the statute of limitations: statute relating to penalties applicable.
4362. View that such liability is in the nature of a specialty, and statutes of limitation not applicable.
4363. When the statute begins to run.
4364. Limitation as to time when action brought against corporation.
4365. Defense not available to director where corporation failed to plead it.
4366. Nor unless raised in the trial court.
4367. Defense of laches.
4368. Defense of pendency of proceedings before assignee or receiver.
4369. Defense of waste of corporate assets by assignee or receiver.
4370. Defense of set-off.
4371. Defense of former adjudication.
4372. Other defenses which have been held unavailing.

§ **4354. Defense of No Corporation.**—This defense has been frequently resorted to in actions growing out of corporate contracts, both by creditors of corporations and by members of the same, when sought to be charged with liability for the corporate debts. It is a defense destitute of justice; it attempts to invoke a collateral issue, which in general can only be settled in a proceeding between the body attempting to exercise corporate powers and the sovereign; and the argument *ab inconvenienti* alone will prevent the courts from listening to it. Accordingly, the courts generally hold that a person who has contracted with a body in writing under a corporate name is estopped to deny that the payee or obligee is such corporation.[1] In like manner, when the stockholders in a body, which has acted as a corporation and held itself out as such, are proceeded against by creditors, they are equally estopped by their own conduct from denying that they are a

[1] Rice *v.* Rock Island &c. Co., 21 Ill. 93, 95; Goodrich *v.* Reynolds, 31 Ill. 490; *s. c.* 83 Am. Dec. 240; Dutchess Cotton Man. *v.* Davis, 14 Johns. (N. Y.) 238, 245; *s. c.* 7 Am. Dec. 459; Hamtramck *v.* Bank of Edwardsville, 2 Mo. 169; Hughes *v.* Bank of Somerset, 5 Litt. (Ky.) 45, 46; Tar River Nav. Co. *v.* Neal, 3 Hawks (N. C.), 520, 536; Worcester Medical Inst. *v.* Harding, 11 Cush. (Mass.) 285, 289; Brookville Turnp. Co. *v.* McCarty, 8 Ind. 392; *s. c.* 65 Am. Dec. 768.

corporation.[1] The rule has even been stated so broadly as that one who has subscribed for stock in a body which has attempted irregularly to create itself a corporation, cannot escape his liability as a shareholder to the creditors of such assumed corporation.[2] Pursuing this principle, we find that if the directors incur liability under a statute by reason of failing to make and file certain certificates and statements therein required, they cannot, when proceeded against for the enforcement of such liability, set up as a defense an irregularity in the organization of the corporation.[3]

§ **4355. When This Defense Available.** — When we consider the rule of interpretation which makes these statutes *penal*,[4] we may conclude that there is ground for the contrary conclusion, but whether more than plausible ground, may be doubtful. The rule being that the plaintiff must allege and prove every element upon which the statute predicates the liability, it might be plausibly argued that the fact of the existence of the corporation is the primary fact to be alleged and proved. If there has been no corporation at all, but only a pretended or usurping board of directors, they, while they might be exonerated from liability in a proceeding under such a statute, would be liable as *original contractors* on another ground already considered.[5] This gives additional

[1] Eaton *v.* Aspinwall, 19 N. Y. 119, 121; Mead *v.* Keeler, 24 Barb. (N. Y.) 20; Abbott *v.* Aspinwall, 26 Barb. (N. Y.) 202; Slocum *v.* Providence Steam &c. Co., 10 R. I. 112; Chubb *v.* Upton, 95 U. S. 665; Methodist Epis. Church *v.* Pickett, 19 N. Y. 482; Upton *v.* Hansbrough, 3 Biss. (U. S.) 417; McCarty *v.* Lavashe, 10 Ch. Leg. News, 342; Buffalo &c. R. Co. *v.* Cary, 26 N. Y. 75; McHose *v.* Wheeler, 45 Pa. St. 32; Rice *v.* Rock Island &c. R. Co., 21 Ill. 93; Tarbell *v.* Page, 24 Ill. 46.

[2] Chubb *v.* Upton, 95 U. S. 665, 667, *per* Mr. Justice Hunt.

[3] Newcomb *v.* Reed, 12 Allen (Mass.), 362. Compare Utley *v.* Union Tool Co., 11 Gray (Mass.), 139, where stockholders escaped liability on this ground, but where, in contradistinction to the former case, the corporation had no charter from the Legislature. The irregularity set up as a defense in the former case was, that the call for the first meeting was signed only by *one* of the persons named in the act of incorporation, and not by a majority of them, as required by the Act of 1855, ch. 140.

[4] *Ante*, § 4164.

[5] *Ante*, § 416, *et seq.*; § 2969, *et seq.*; § 4218.

point to the suggestion already made by the author, that the courts might better have applied the rule of remedial construction to these statutes. For if we carry out the rule of strict construction by holding that the plaintiff must allege that there *was* a corporation, then it will follow that the wrong-doing directors may defend against such an action by showing that they did a *cumulative wrong*, and one much more grievous than most of the wrongs denounced by these statutes,—the wrong of deceiving the public by acting as directors of a pretended corporation that did not exist. Nevertheless there are several decisions that land themselves in this predicament. Thus, it has been held, under a statute of New Jersey authorizing any persons to associate and form a corporation, and choose a board of directors, and under its direction carry on the business, that if the associates choose no directors, but merely a president, who is, in fact, the owner of the concern, and who controls its business, they are to be regarded as a corporation, but are not liable in the character of directors, but are liable in equity *as shareholders*, to be charged with debts of the concern [1] to the extent unpaid on their shares. So, where it appeared in such an action that the defendants had drawn up articles of incorporation, but with the understanding that they were not to take effect until certain things were done, which never were done, it was held that this did not constitute them a corporation, and that the president and directors could not be made liable under a statute [2] making such officers personally liable for debts contracted by the corporation or voluntary association before complying with certain statutory requirements.[3] So, where a member of an association which had failed of a legal incorporation purchased claims against the association, it was held that this did not give an action against the directors, because it was a partnership, and one partner cannot sue the others at law.[4] So, it has been held that, with the expiration of a bank

[1] Kinsela *v.* Cataract City Bank, 18 N. J. Eq. 158.

[2] Rev. Laws Vt., § 3279.

[3] Corey *v.* Morrill, 61 Vt. 598; *s. c.* 17 Atl. Rep. 840.

[4] Coleman *v.* Coleman, 78 Ind. 344.

charter, the personal liability of the directors for *overissues* of circulating notes, ceases:[1] a decision entitled to no respect.

§ 4356. Defense of Negligence, Ignorance of Law, Want of Guilty Scienter. — This subject, which has already been considered in a different relation,[2] invites attention to the distinction between cases where the statute *enjoins an affirmative duty,* and where it *prohibits a wrongful act.* In the first case, negligent ignorance is no defense: every director, when he accepts the office, takes upon himself the obligation of learning the law and complying with its mandates; and he will obviously not be heard to say that he depended upon his fellows to perform the duty and that they neglected it.[3] But in the second case, where the statutes prohibit a particular act, many of the statutes, as already seen,[4] make the liability of each director depend upon his *assent* to the doing of the particular act, and this *assent* must in general be affirmatively shown by the plaintiff,[5] unless, as is often the case, the statute changes the ordinary rule of evidence and creates a presumption of assent, in the absence of some prescribed affirmative act of dissent.[6] On the one hand, where the directors are sued under a statute making them liable for the debts of the corporation contracted during the time when they have been in default under a statute in *filing certain prescribed reports,* it will be no defense that they were ignorant of the existence of the law, nor that they did not know whether or not the reports had been filed, and had not intentionally neglected to conform to the requirements of the statute, and indeed had no knowledge of such requirements and thought nothing about them. Although the statute only fixes personal liability upon the

[1] Moultrie *v.* Hoge, 21 Ga. 513. *Contra:* Moultrie *v.* Smiley, 16 Ga. 289. As to the *manner of proving* the corporate character of the association in a suit in equity to enforce the liability of the officers of a manufacturing company, see Priest *v.* Essex Hat Man. Co., 115 Mass. 380; First Nat. Bank *v.* Almy, 117 Mass.476.

[2] *Ante,* § 4108.

[3] Van Etten *v.* Eaton, 19 Mich. 187.

[4] *Ante,* § 4266.

[5] Patterson *v.* Stewart, 41 Minn. 84; *s. c.* 16 Am. St. Rep. 671; 42 N. W. Rep. 926.

[6] *Post,* § 4357.

directors when they "intentionally neglect or refuse to comply with the provisions and to perform the duties required of them" by its terms, it is not incumbent upon a person sued under it to prove that the omission was intentional: the intent will be inferred from the neglect of the duty. If the rule were otherwise, the directors might at their pleasure neglect to report, and, by a careful abstinence from any overt act or word to mark their design, make their liability depend upon their own testimony; and a resort to that, by one seeking to fix a liability upon them, might be made difficult, and sometimes impossible, by accident or contrivance.[1] On the other hand, where the statute enacts a liability to a negative prohibition, it has been justly reasoned that to constitute "assent," there must be something more than mere negligence on the part of a director in not knowing what, in the exercise of proper care, he ought to have known. There must be some willful or intentional violation of duty, assenting to it, knowing that the act is being done, or that it is about to be done. But if, *with such knowledge*, he neither objects to nor opposes it when his duty requires, and when he has the opportunity of doing so, this is "assent."[2]

§ 4357. Statutes Creating a Presumption of Assent.— Many statutes exist embodying the principle that assent should be presumed, unless some affirmative act of dissent is shown by the director defending on this ground. Many of these statutes have already been referred to in their special connections. Most of them are in terms applicable to cases where the statute prohibits the doing of an affirmative act, but some of them unnecessarily extend to cases where the statutes impose penalties or liabilities for negative omissions.[3]

[1] Van Etten *v.* Eaton, 19 Mich. 187. But see Breitung *v.* Lindauer, 37 Mich. 217.

[2] Patterson *v.* Stewart, 41 Minn. 84; *s. c.* 16 Am. St. Rep. 671; 42 N. W. Rep. 926.

[3] The following may be consulted as examples of them: Ga. Code 1873, § 4427; Rev. Stats. N. Y. (Banks & Bros., 6th ed., 1876), vol. II., pp. 298, 299, §§ 12, 13; Cal. Penal Code, §§ 568, 569, 570. Similarly, see Comp. Laws Utah 1876, p. 635, § 329; Gen. Stats. N. H. 1867, p. 281, § 6; Gen. Stats. R. I. 1872, p. 296, § 24. See also *Ibid.*, p. 306, § 15.

§ 4358. Director Exonerated by Resigning or Abandoning the Office. — Where the liability imposed by a statute of this kind has not attached, a director may, of course, escape such liability by resigning his office. Thus if, at the expiration of his term, a trustee retires from the company, and afterwards performs no official act, and assumes no official authority, he cannot be held liable as trustee, under such a statute, for a subsequent omission to make and file a report.[1] In like manner, where a director resigned after the corporation had incurred the debt in respect of which it was sought to charge him, but before any default had taken place in filing the report prescribed by the statute, it was held that he was not liable, and further, that he need not have given notice of his intent to resign, to any person other than his associates.[2] This was quite obvious; for the statutory wrong did not consist in contracting the debt, but in failing to file the report, and he had not been guilty of that. In the absence of a statute or a contract to the contrary, a man has a right to resign any public or private office or employment, and thereby relieve himself from the liabilities attached to it; and the general rule therefore is, that the *acceptance* of a resignation is not necessary to make it operative. Accordingly, the director of a corporation may relieve himself from liability under these statutes, by resigning his office, although his resignation has not been acted on by the board or entered in the books.[3] Nor is it material what *form* his resignation takes, so that it is distinct, unequivocal, and clearly proved. He may make his resignation *orally*, and thus escape liability accruing from subsequent mismanagement.[4] Nay, a resignation may be effected for the purposes under discussion, though it be not made by any words, oral or written, provided it is evidenced by *unequivocal acts*. Thus, it was held that a director who had sold out his stock, and thenceforth ceased to take any part in the affairs of the corporation, was not bound to tender a formal resigna-

[1] Reed *v.* Keese, 37 N. Y. Super. Ct. 269.

[2] Bruce *v.* Platt, 80 N. Y. 379.

[3] Blake *v.* Wheeler, 14 Hun (N. Y.), 496.

[4] Morvius *v.* Lee, 30 Fed. Rep. 298.

tion, nor to see that a successor was elected; nor to be responsible for the acts of the managers at its dissolution five years afterwards, although no successors to the directors had ever been elected.[1] The same court has held that, in such an action, it is error to refuse to allow the defendant to prove that, before the cause of action accrued, he was *adjudged a bankrupt*, and *assigned* and delivered *his stock* in the corporation to his assignee in bankruptcy; that he had received a discharge in bankruptcy; and that, since the filing of his petition in bankruptcy, he had had no connection with the corporation, nor in any way made himself a trustee thereof.[2] So, in New Jersey, an associate who took no part in the transactions of the bank, after he had signed the certificate required by the statute, could not be charged with implied knowledge or notice, as a director and manager.[3]

§ **4359. Other Evidence of Want of Assent.**—Where the statute is of the second class already referred to,[4]—where it prohibits the doing of some *affirmative* act,—a director is not liable, in the absence of a statute establishing some special mode of exoneration,[5] who refuses to consent to the proposed act and protests against it.[6] There is a doubtful holding to the effect that the trustee of a corporation does not assent to the creation of an indebtedness exceeding its capital stock, by a *failure to dissent*, when *afterwards* informed that the indebtedness has been created;[7] nor do trustees assent who attend no meetings, are never consulted, and do nothing but sign annual reports on the strength of their reliance on the truth of the statement of a co-trustee.[8] On this question of the liability of a director for the acts of his co-directors, some English chancery cases are instructive. One such case holds

[1] Sturges *v.* Vanderbilt, 73 N. Y. 384, Miller, J., dissenting.

[2] Philadelphia &c. Co. *v.* Hotchkiss, 82 N. Y. 471.

[3] Kinsela *v.* Cataract City Bank, 18 N. J. Eq. 158.

[4] *Ante*, § 4357.

[5] Such as those considered, *ante*, § 4266.

[6] Schofield *v.* Henderson, 67 Ind. 258.

[7] Patterson *v.* Robinson, 36 Hun (N. Y.), 622.

[8] *Ibid.*

that although a director of a company is not bound to look back through the minute-book of the company into entries made in it before he became a director; yet, where subsequently to his becoming a director, he is a party to dealings founded on those noticed in such prior entries, and allows his brother directors to act and proceed upon the notion that he affirms and adopts the transactions to which such entries relate, and this course of action goes on during two years,— he is precluded from impeaching such transactions, unless he can establish a case of deception, or want of due information.[1] In another such case, it appeared that at the meeting at which an amalgamation with another company was resolved, one of the directors opposed the project, but, finding that he was in a minority, insisted on the insertion of certain terms, which, as he believed, would prevent its taking place, and a resolution was then passed for an amalgamation subject to those terms. It was held that he was not responsible in respect of the amalgamation.[2] In a case at law, where deposits were paid, according to a rule of a projected joint-stock company, as set forth in the prospectus, to certain bankers, and the account with the bank was kept in the name of five directors, — it was held, in an action to recover back the deposits, the scheme having become *abortive*, that *other directors* who had interfered in the management were liable in an action for money had and received, along with those five.[3] Outside of the operation of statutes, the subject is illustrated by numerous holdings in respect of the liability of promoters, already considered.[4] The *minutes* of the proceedings of the corporation are admissible to show a trustee's knowledge of the falsity of a report made by the board of which he was a member.[5]

§ 4360. Assent of the Plaintiff to the Prohibited Act. — Where the plaintiff has himself assented, either in the char-

[1] Burt *v.* British &c. Association, 4 De Gex & J. 158; *s. c.* 28 L. J. (Ch.) 731.

[2] Ex parte Johnson, 31 Eng. L. & Eq. 430.

[3] Johnson *v.* Goslett, 18 C. B. 728; *s. c.* 3 C. B. (N. S.) 569; 37 Eng. L. & Eq. 308.

[4] *Ante*, ch. 10, art. I.

[5] Pier *v.* George, 20 Hun (N. Y.), 210.

acter of a director or otherwise, to the doing of a prohibited act in respect of which he seeks to charge a director, this fact will, in general, be a good defense, in accordance with the maxim *volenti non fit injuria*. This principle governed a leading case where a creditor of a corporation was a stockholder, and also a trustee of the corporation, and was present and assented to a vote of the trustees relative to enforcing payment of subscriptions, by which it was resolved not to sue stockholders after payment by them of a certain portion of their subscription, and it was held that he could not sue the stockholders for a debt due him from the corporation.[1] So, the view has been expressed that if a manufacturing corporation is indebted to a firm, one *member* of which is a trustee of the corporation, his *assignees* will not be allowed to pursue such a statutory remedy, since this would enable him to profit by his own wrong or negligence.[2]

§ 4361. Defense of the Statute of Limitations — Statute Relating to Penalties Applicable. — Statutes of this kind being regarded as penal,[3] actions under them are governed by the statute of limitations which applies to actions upon statutes for penalties, and not by the statutes which relate to other actions. Thus, actions under section 12 of the New York statute of 1848, chapter 40, which makes directors liable for failure to file certain annual reports, and under section 13 of the same act, which makes them liable for declaring and paying dividends when the company is insolvent, are governed by the New York statute of three years, which provides that "an action upon a statute for a penalty or forfeiture, where the action is given to the party aggrieved," shall be commenced within three years; and not by the statute which provides that "an action upon the liability created by statute, other than a penalty or forfeiture," may be commenced within

[1] Slee *v.* Bloom, 5 Johns. Ch. (N. Y.) 366. The following case, which was an action against the corporation, involved an application of the principle: Philadelphia &c. R. Co. *v.* Love, 125 Pa. St. 488; *s. c.* 17 Atl. Rep. 455.

[2] Knox *v.* Baldwin, 80 N. Y. 610.

[3] *Ante*, § 4164.

six years.[1] So the liability imposed by a statute of Ohio[2] on stockholders, shareholders, or partners in corporations, for issuing unauthorized notes in the similitude of bank paper, was an action for a penalty, and, under the statute of limitations of that State, an action to enforce it was barred in four years;[3] and so was the liability under a special charter elsewhere set out.[4] But in Georgia it is held that such statutes are not penal, but are *remedial*, and that the statute of limitations of six months, relating to penalties, does not therefore apply.[5] So, in Minnesota, where the action was brought under a statute by a creditor of an insolvent corporation, to recover from the directors for certain alleged violations of law, consisting in the issuing of stock without the same being paid for, in making unauthorized loans, and in making and indorsing negotiable paper without consideration, it was held that the period of limitation was *three years*, being the one prescribed in respect of actions upon "a statute for a penalty or forfeiture, where the action is given to the party aggrieved," etc.[6]

§ 4362. View that Such Liability is in the Nature of a Specialty, and Statutes of Limitation not Applicable.— Widely opposed to the view that the statute of limitations relating to actions for penalties applies, is the view that the liability of directors created by statute is in the nature of a specialty, and, therefore not within the operation of the statute of limitations, and is therefore not barred till the expiration of twenty years.[7]

[1] Merchants' Bank *v.* Bliss, 35 N. Y. 412; affirming *s. c.* 1 Robt. (N. Y.) 391. See also Bird *v.* Hayden, 1 Robt. (N. Y.) 383; *s. c.* 2 Abb. Pr. (N. S.) (N.Y.) 391; Chapman *v.* Comstock, 58 Hun (N.Y.), 325; *s. c.* 34 N.Y. St. Rep. 517; 11 N. Y. Supp. 920; N. Y. Code Civ. Proc., § 383. Compare *ante*, §§ 1991, 3767. In some States there are *special statutes of limitations* relating to such actions,—such as Conn. Acts 1879, ch. CVI., p. 455.

[2] Ohio Act of Jan. 27, 1816.

[3] Lawler *v.* Burt, 7 Ohio St. 340; overruling Lawler *v.* Walker, 18 Ohio, 151.

[4] Sturges *v.* Burton, 8 Ohio St. 215; *s. c.* 72 Am. Dec. 582.

[5] Neal *v.* Moultrie, 12 Ga. 104.

[6] Merchants' Nat. Bank *v.* Northwestern Man. &c. Co., 48 Minn. 349; *s. c.* 51 N. W. Rep. 117.

[7] Neal *v.* Moultrie, 12 Ga. 104; Banks *v.* Darden, 18 Ga. 318, 340;

§ 4363. When the Statute Begins to Run. — There is a holding under the New York Manufacturing Companies Act, which may be generalized to the effect that where a statute requires certain duties of directors of corporations, and makes them liable in general terms, in an action founded on the statute, for all debts of the corporation which may be contracted during the period of such neglect, or their refusal to perform such duties, the statute of limitations begins to run from the time the *contract is entered into*, and not from the time the judgment is recovered against the corporation. The reason is, that the right of action is deemed to accrue from the time when the debt was contracted,—the court meaning, we take it, from the time when the debt became due,— and that the judgment at law against the corporation did not in any manner in-

Hargroves *v.* Chambers, 30 Ga. 580, 599. An explanation of this may be useful. Many of the American States borrowed from England the statute of 21 James I., ch. 16, section 3 of which enacted that "all actions of debt *without specialty* shall be brought within six years." It was, therefore, a part of the law of this country that specialty debts were not within the statute of limitations, and this rule, no doubt, lingers yet in some of the States; but where this is so, courts have enacted a statute of their own by raising a presumption of payment after a lapse of twenty years. The liability of shareholders in England arising under a deed of settlement, as it is called, has been held to be a debt by specialty, and therefore not within the statute. Helby's case, L. R. 2 Eq. 167, *per* Kindersley, V. C. But another court of that country, in a more authoritative decision, ten years before, held otherwise. Robinson's Executor's case, 6 De Gex, M. & G. 572. It is old law that a liability founded on a statute is in the nature of a specialty. Com. Dig. *temps.* G. 15: Jones *v.* Pope, 1 Saund. 37; Hodsden *v.* Harridge, 2 Saund. 61, 65; Talory *v.* Jackson, Cro. Car. 513; Bullard *v.* Bell, 1 Mason (U. S.), 289; Shepherd *v.* Hills, 32 Eng. L. & Eq. 533; Pease *v.* Howard, 14 Johns. (N. Y.) 479, 480; Griffin *v.* Heaton, 2 Bailey (S. C.), 58; Ward *v.* Reeder, 2 Har. & McH. (Md.) 154; Lane *v.* Morris, 10 Ga. 162; Thornton *v.* Lane, 11 Ga. 459; Hargroves *v.* Chambers, 30 Ga. 580, 599. Such a liability was therefore not within the statute of James, and in this country was subject only to the presumption of payment after the lapse of twenty years. The statutory liability of stockholders to pay the debts of the corporation has been held to be in the nature of a specialty, and within this rule. Bullard *v.* Bell, 1 Mason (U. S.), 289; Thornton *v.* Lane, 11 Ga. 459, 502; Lane *v.* Morris, 10 Ga. 162. The Supreme Court of the United States has, however, ruled otherwise in a decision which, it is thought, must be accepted as overruling Bullard *v.* Bell: Carrol *v.* Green, 92 U. S. 509.

volve this right of action.[1] But this holding seems to have been qualified in a subsequent case in the same court, where, proceeding upon the general principle that a statute of limitations does not begin to run *until a right action accrues*, the court held that it *does not* begin to run from the time of the creation of the debt against the corporation; for until the debt is *due*, there is no right of action for it against any one;[2] and this view has been taken elsewhere.[3] Such a statute necessarily begins to run from the time of default in making the report; because the indebtedness of the corporation may not then be due, though it may have been contracted. It may be an indebtedness within the meaning of the statute, but it may be what is termed *debitum in præsenti, solvendum in futuro,* in which case the statute would not begin to run until the maturity of the debt after the default, the same having been contracted at the time of the default. So also, where the debt has become due within the period of the default, and has nevertheless been *extended* by the consent of the creditor, the statute does not run in favor of the defaulting trustee.[4] The view is that, for the purpose of determining the time within which such actions may be brought, it is immaterial when the debt against the corporation arose; but if it in fact existed and might have been the subject of an action at the time of the alleged default in complying with the requirement of the statute touching the filing of an annual report, an action may be commenced against the trustees at any time within three years thereafter. When, therefore, the plaintiff loaned money to a manufacturing corporation in 1873, and the corporation omitted to file an annual report in January, 1875, it was held that an action against the trustees, commenced in March, 1877, was in time.[5]

[1] Merchants' Bank *v.* Bliss, 1 Robt. (N. Y.) 391; *s. c.* 13 Abb. Pr. (N. Y.) 225; 21 How. Pr. (N. Y.) 365; affirmed, 35 N. Y. 412.

[2] Duckworth *v.* Roach, 81 N. Y. 49; Jones *v.* Barlow, 62 N. Y. 202, 207.

[3] Sullivan *v.* Sullivan Man. Co., 20 S. C. 79, 90.

[4] Jones *v.* Barlow, 62 N. Y. 202, 206.

[5] Duckworth *v.* Roach, 81 N. Y. 49.

Each failure of the directors to file the *annual report* required by a statute gives a right of action against them in respect of debts contracted during the period of that delinquency, and the statute of limitations begins to run in favor of the directors from the *maturity* of such debts, and their failure to file such reports in subsequent years does not create a fresh liability in respect of the debts already referred to, so as to prolong the period of the statute.[1] Where the indebtedness consists of several notes maturing at different times, and these are consolidated, and a new note given for the entire indebtedness, then the question whether the new note is a new debt, so that the statute of limitations does not begin to run until its maturity, or whether it is merely a renewal or prolongation of the several debts evidenced by the pre-existing notes, has been held to depend upon the *intention* of the parties; and where in such a case the plaintiff failed to make it clearly appear that the intention was to create a new debt, it was held that the statute of limitations ran from the date of the maturity of the previous notes respectively, and a judgment was affirmed allowing a recovery upon some of the notes upon that principle and denying it as to others,[2] — a conclusion which the writer believes to be unsound for reasons already stated.[3]

§ 4364. Limitation as to Time when Action Brought against Corporation. — A statute of New York, relating to corporations for social and recreative purposes, provides that, "the trustees of any company or corporation, organized under the provisions of this act, shall be jointly and severally liable for all debts due from said company or corporation, contracted while they were trustees, provided said debts are payable within one year from the time they shall have been contracted, and provided a suit for the collection of the same shall be brought within one year after the debt shall have become due

[1] Chapman *v.* Comstock, 58 Hun (N. Y.), 325; *s. c.* 34 N. Y. St. Rep. 517; 11 N. Y. Supp. 920.

[2] Sullivan *v.* Sullivan Man. Co., 20 S. C. 79, 91.

[3] *Ante*, §§ 2018, 3117, 4196.

and payable."[1] It became a question whether the statute was satisfied by a suit brought within one year against the corporation, or whether it required that the suit brought against the trustees should have been brought within one year; and it was held that the statute required that the suit should be brought against the trustees within the year. The right of action given by the statute was not saved by bringing suit against the corporation within a year, and then delaying several years before suing the directors.[2] The terms of the statute being ambiguous, this construction conformed to the rule that such statutes, being penal, are to be strictly construed.[3]

§ 4365. Defense not Available to Director where Corporation Failed to Plead it.—It has been held in New York that the defense that the debt itself is barred by the statute of limitations is not available to the director, where the corporation failed to plead the statute, and suffered a judgment for the debt to be recovered against it.[4] But this holding is totally irreconcilable with the general course of the holdings in that State, which are to the effect that the judgment against the corporation is not the foundation of the action against the director, and is not even admissible in evidence in such an action to prove the existence of the debt, but that the creditor must sue on the original cause of action.[5] If the judgment is not admissible in evidence to prove the existence of the debt, it is difficult to understand how either it, or the proceedings which resulted in it, can be so admitted to prove a state of facts taking it out of the statute of limitations. The rule ought to be consistent one way or the other. That judgment and the proceedings which led up to it are either an estoppel

[1] N. Y. Laws 1865, ch. 368, § 7.

[2] Hall *v.* Siegel, 7 Lans. (N. Y.) 206; *s. c.* 13 Abb. Pr. (N. S.) (N. Y.) 178. Although the conclusion arrived at by the court seems sound, it is to be observed that it proceeds upon the authority of Miller *v.* White, 57 Barb. (N. Y.) 504, which has been since reversed (50 N. Y. 137); and its authority may therefore be considered doubtful.

[3] N. Y. Stat. 1848, ch. 40, § 12.

[4] Van Cott *v.* Van Brunt, 2 Abb. N. Cas. (N. Y.) 295.

[5] *Ante*, § 4329. Compare *ante*, § 3077.

or not. If not, and if the action against the director is upon the original demand, then every defense which would have been open to the corporation against that demand ought to remain open to him.

§ **4366. Nor unless Raised in the Trial Court.** — In such a case it is scarcely necessary to suggest that the defendants cannot bring the action against them within the statute of limitations, on the mere suggestion on appeal that there was an omission to file the report required by the statute on a previous year; they must set that fact up as a defense and prove it at the trial.[1] When, therefore, in an action against trustees of a corporation organized under the New York General Manufacturing Act, to recover a debt of the corporation because of a failure to make and file an annual report, certain of the defendants, in attempting to set up the statute of limitations, failed to allege that they were trustees at the time of defaults stated by them to have occurred in previous years, and failed to allege a default on the part of the corporation in performing the corporate duty of making a report, it was held that the answer stated no defense.[2]

§ **4367. Defense of Laches.** — It has been held *no defense* to an action to charge directors under such a statute, that at the time the debt matured and for a long time afterwards, the corporation was solvent, and its stockholders severally and individually liable for all its debts, by reason of the non-payment of its capital stock; that the plaintiff neglected to institute suit for two years; that by reason of such neglect, the plaintiff released and discharged the stockholders from personal liability; and that no notice was ever given to the defendants of the plaintiff's claim, nor had they any opportunity of being subrogated to the rights and remedies of the plaintiff against the corporation while solvent, or against the stockholders before they were released, as above stated.[3] A single Federal

[1] Duckworth *v.* Roach, 81 N.Y. 49.

[2] Cornell *v.* Roach, 101 N. Y. 373.

[3] Merchants' Bank *v.* Bliss, 1 Robt. (N. Y.) 391.

court has held that the right to proceed against a director of a national bank [1] is lost by allowing such a period of time to elapse as cuts off the right to *forfeit the charter* under the same section, by reason of the misconduct complained of; [2] but this view is clearly untenable.[3]

§ 4368. Defense of Pendency of Proceedings before Assignee or Receiver. — It has been held that the directors and stockholders of a banking corporation cannot, by making an *assignment* to which the creditors of the bank are not parties nor consenting, deprive such creditors of their remedies against them for a breach of duties.[4] It has also been held that it is no defense to an action against bank directors, to charge them with liability for issuing notes of the bank in excess of three times the amount of the capital stock of the bank, under a statute making them liable in such cases for the debts of the bank, that proceedings were commenced by the bank commissioners against such bank; that in such proceedings a receiver was appointed to take entire charge of the assets of the bank; and that the notes sued on by the plaintiff were by him deposited with such receiver as a part of the liabilities of the bank, in order to receive his proportionate share of the assets of the bank when distributed by the receiver. It was deemed necessary, in order that this should constitute a defense, that it should be averred either that the receiver had paid the notes, or that there were assets in his hands sufficient to pay them.[5] Another court has held that the fact that the affairs of the corporation have been placed in the hands of a *receiver* neither takes away nor suspends this right of action.[6]

§ 4369. Defense of Waste of Corporate Assets by Assignee or Receiver. — Whether the directors of a corporation can

[1] Under § 5239, Rev. Stat. U. S.

[2] Welles *v.* Graves, 41 Fed. Rep. 459; *s. c.* 7 Rail. & Corp. L. J. 392.

[3] See *ante*, § 4273.

[4] Schley *v.* Dixon, 24 Ga. 273; *s. c.* 71 Am. Dec. 121.

[5] White *v.* How, 3 McLean (U. S.), 111, 291.

[6] Patterson *v.* Stewart, 41 Minn. 84; *s. c.* 16 Am. St. Rep. 671; 42 N. W. Rep. 926.

defend an action brought by creditors to charge them with liability for certain official derelictions, must depend upon the fact whether the assignee was the agent of the creditors or not. If he was appointed by the voluntary action of the bank, it is too plain for discussion that the creditors are not to be deprived of any remedy given them by law against the directors, on the ground of his misconduct in wasting the corporate assets, which are the primary fund or security.[1] It has been held that such a defense is unavailable, in an action to charge a stockholder for the debts of the corporation, although his liability is somewhat in the nature of that of a surety.[2] Nor is it any defense to an action under a statute against directors of a bank, that the assignee was not sued; for the bank could not, by making an assignment, deprive the creditors of any remedy they might have against the directors.

§ **4370. Defense of Set-off.**—Under a statute of New York, which provided that in case the debts of any corporation should, at any time, exceed three times the amount of the capital stock actually paid in, and that in case of any excess, the directors under whose administration the same may have happened . . . . should be jointly and severally liable for such excess to the corporation, or, in the event of its dissolution, to its creditors,[3] the directors, when sued, to enforce this liability, may set off any demands they may have against the corporation for advances made to it.[4] This isolated case will not, however, be sufficient to establish any general rule on the subject.[5] A judgment against a corporation upon which

[1] It was so resolved by the Supreme Court of Georgia, in Hargroves *v.* Chambers, 30 Ga. 580, after reviewing the following cases which bear by analogy on the question: Carter *v.* Barnadiston, 1 P. Wms. 505; Ivy *v.* Gilbert, 2 P. Wms. 20; Harrison *v.* Cage, 2 Vern. 85; Smith *v.* Smith, 2 Vern. 178; Hutchinson *v.* Massareene, 2 Ball & B. 49; Rigge *v.* Bowater, 3 Bro. Ch. 365; Wright *v.* Nutt, 1 H. Black. 136; Wright *v.* Simpson, 6 Ves. 714, 726; Holditch *v.* Mist, 1 P. Wms. 695; Robinson *v.* Lane, 19 Ga. 364.

[2] Stewart *v.* Lay, 45 Iowa, 604; *ante*, §§ 1970, 3688, 3763.

[3] Rev. Stat. N. Y. 1835, p. 604, § 3.

[4] Tallmadge *v.* Fishkill Iron Co., 4 Barb. (N. Y.) 382.

[5] A discussion of the subject, so far as it concerns the liability of stockholders, will be found *ante*, § 3785, *et seq.*

a particular director may be charged under a statute, will be available as a set-off to an action by such director against the owner of such judgment; but the plea of set-off must show that the amount of the corporate indebtedness which, under the statute, the plaintiff has become liable to pay, is equal to the defendant's judgment.[1] For the purpose of determining the extent of the excess of the debt of the corporation over its capital stock, under a statute[2] making the directors jointly and severally liable when the debts of the corporation exceed the capital stock to the extent of such excess existing when the suit is commenced against the corporation, an indebtedness of the corporation *to one of its directors* constitutes a debt due by the corporation, within the meaning of the statute, and is not to be deducted for the purpose of reducing the aggregate volume of the debts, on the principle of a set-off of mutual credits, so as to reduce the excess for which the directors are liable, or to make it appear that there is no excess. In other words, if the capital is $100,000, and the indebtedness at the commencement of the suit is $150,000, and $50,000 of this is due to the directors themselves, *other creditors* can charge the directors to the extent of $50,000.[3]

§ **4371. Defense of Former Adjudication.** — Under a statute of Massachusetts,[4] which provides that in certain cases the officers of corporations shall be jointly and severally liable for all debts of the corporation, the fact that a plaintiff has taken *judgment against the corporation* does not preclude him from enforcing the liabilities of the officers for the original debt by a bill in equity;[5] and it may be assumed that this is the rule in all jurisdictions under such statutes as we are considering. So, the recovery of a *judgment against a stockholder,*

[1] Chambers *v.* Lewis, 28 N. Y. 454. As to the defense of set-off where the action is against a corporation by a shareholder for money lent, see Milvain *v.* Mather, 5 Ex. 55; *s. c.* 1 Lown., M. & P. 220; 19 L. J. (Ex.) 227. Set-off of advances made by a shareholder against an action for a call, see Ex parte Chippendale, 4 De Gex, M. & G. 19.

[2] Pub. Stats. Mass., ch. 106, § 60.

[3] Thacher *v.* King, 156 Mass. 490; *s. c.* 31 N. E. Rep. 648.

[4] Mass. Act 1863, ch. 246, § 2.

[5] Byers *v.* Franklin Coal Co., 106 Mass. 131.

upon his individual liability for the debts of the corporation under a statutory provision, is not a bar or merger of a right of action against a trustee individually for the same claim, but upon a different state of facts, and under a different statutory provision.[1] So, by a statute in Michigan, relating to banking associations, a *judgment* rendered *against any officer or stockholder*, or any number thereof, shall not be a bar to a prosecution or suit against any *other* officer or stockholder of such association or bank, for the recovery of the same indebtedness.[2] And this would seem to embody an obvious principle, which is that a judgment against some other officer or stockholder is no bar until it has been satisfied.[3]

§ 4372. Other Defenses Which have been Held Unavailing. There is a doubtful decision to the effect that where the election of a trustee of a corporation is clearly invalid, the person so elected will not be held liable for neglect of the corporation to publish and file a report as required by statute, notwithstanding he accepted the appointment and acted as such trustee; nor is he estopped from denying that he is trustee.[4] This decision is opposed to a principle already considered,[5] which makes *de facto* directors liable the same as directors *de jure*. Directors, when sued to enforce their personal liability, cannot question the *original consideration* of a corporate *note indorsed before maturity* to a *bona fide* indorsee for value.[6] It is no defense on the part of directors when so sued that there has been a judgment of *forfeiture* against the corporation, or that its charter has expired by its own limitation.[7] It is no defense to an action against a director by a creditor of the corporation, to charge him under a statute[8] for signing *false statements*, that the defendant is *also a creditor*.[9] The

[1] Vincent *v.* Sands, 11 Abb. Pr. (N. S.) (N. Y.) 366; *s. c.* 42 How. Pr. 231.

[2] Comp. Laws Mich. 1871, § 2222.

[3] See *ante*, § 3669.

[4] Craw *v.* Easterly, 4 Lans. (N. Y.) 513.

[5] *Ante*, § 3901.

[6] Cooke *v.* Pearce, 23 S. C. 239.

[7] Hargroves *v.* Chambers, 30 Ga. 580.

[8] N. Y. Laws 1875, ch. 611.

[9] Richards *v.* Crocker, 19 Abb. N. Cas. (N. Y.) 73.

liquidation of the debt by the company, and payment thereof in its promissory notes, does not cancel the indebtedness, and does not affect the liability of the trustees.[1] Where a corporation, incorporated as a road and bridge company, was, by a subsequent act of the Legislature, permitted to *form itself into two distinct companies*, one designated a turnpike company, and the other a bridge company, this did not exonerate the officers of the road company from the penalties imposed by the original act, it being manifest that the Legislature did not intend to relieve them from their liabilities.[2]

[1] Deming *v.* Puleston, 35 N. Y. Super. Ct. 309.

[2] Kane *v.* People, 8 Wend. (N. Y.) 203. It is no defense to an action against a *stockholder* under a statute of Massachusetts, to show that the officers have sufficient property to pay the debt. Brayton *v.* New England &c. Co., 11 Gray (Mass.), 493.

CHAPTER LXXXIV.

CONTRIBUTION AND SUBROGATION.

SECTION
4376. When wrong-doing directors entitled to contribution as among themselves.
4377. Whether contribution in case of affirmative acts done contrary to statutory prohibitions.
4378. Statutes granting or withholding this right.

§ 4376. When Wrong-doing Directors Entitled to Contribution as among Themselves.—It is familiar law that there can be no action for contribution among *tort-feasors*.[1] But a distinction is taken in this regard between acts of *misfeasance*, such as involve bad motive or moral turpitude, and acts which, though wrongful, consist of mere *negligence* or *non-feasance*. It is in the former class of actions that there is no contribution among wrong-doers; in the latter cases there may be. Thus, if one of two proprietors has been compelled to pay damages for a negligent injury done by their common servant, he may have contribution from his co-proprietor.[2] So, if a traveler falls into an excavation in the street of a city, made by the negligence of an abutting owner, and he recovers damages of the city, the city may have an action over against the private owner. Although the city was primarily liable to the traveler for failing to keep its streets in repair, yet the wrong was primarily that of a private abutter.[3] Following out this

[1] Merryweather *v.* Nixan, 8 T. R. 186; Miller *v.* Fenton, 11 Paige (N.Y.), 18; Peck *v.* Ellis, 2 Johns. Ch. (N. Y.) 131.

[2] Wooley *v.* Batte, 2 Car. & P. 417. But see Oakes *v.* Spaulding, 40 Vt. 347; *s. c.* 94 Am. Dec. 404; and Spaulding *v.* Oakes, 42 Vt. 343, where the wrongful act consisted in keeping a vicious animal.

[3] Lowell *v.* Boston &c. R. Co., 23 Pick. (Mass.) 24; *s. c.* 34 Am. Dec. 33; Lowell *v.* Short, 4 Cush. (Mass.) 275; Milford *v.* Holbrook, 9 Allen (Mass.), 17; *s. c.* 85 Am. Dec. 735; Boston *v.* Worthington, 10 Gray (Mass.), 496;

doctrine, it is held that where a wrong, for which a director has been made liable, consists of mere negligence,—a failure to do something which the law requires, such as the filing of an annual certificate or report,—the law imposing the duty equally upon all the directors, and all of them being equally guilty of the neglect, the one who, under the terms of the statute, has thus been compelled to pay a corporate debt, may have contribution from the others. But it was conceded that this would not be so if the wrong consisted in the making of a false report. For such a transaction none would be responsible except those actually concurring in it, and the maxim *ex turpi causa non oritur actio* would apply.[1] There is, however, a contrary decision in the Supreme Court of New York, where the principle is asserted on the authority of Pearson *v.* Skelton,[2] that no contribution is allowed among wrong-doers, where a liability arises from negligence, if the party made liable knew that he was committing an unlawful act. "Either of the trustees," said Ingraham, J., "might have avoided this liability by attending to the duty imposed upon him by the statute. He cannot charge any other trustees with the consequences of his own negligence. The statute imposes the duty on each, the liability attaches to each, and the policy of law is to leave each one to the consequences of his own negligence, so as to insure stricter attention to the provisions of the statute on the part of each of the trustees, which might not be the

s. c. 71 Am. Dec. 678; Woburn *v.* Boston &c. R. Co., 109 Mass. 283; Woburn *v.* Henshaw, 101 Mass. 193; *s. c.* 3 Am. Rep. 333; West Boylston *v.* Mason, 102 Mass. 341; Westfield *v.* Mayo, 122 Mass. 100; *s. c.* 23 Am. Rep. 292; Centreville *v.* Woods, 57 Ind. 192; Portland *v.* Richardson, 54 Me. 46; *s. c.* 89 Am. Dec. 720; Lowell *v.* Spaulding, 4 Cush. (Mass.) 277; *s. c.* 50 Am. Dec. 775; Littleton *v.* Richardson, 34 N. H. 179; *s. c.* 66 Am. Dec. 759; Chicago *v.* Robbins, 2 Black (U. S.), 418; Robbins *v.* Chicago, 4 Wall. (U. S.) 657; Rochester *v.* Montgomery, 9 Hun (N. Y.), 394 (affirmed 72 N. Y. 65); Brooklyn *v.* Brooklyn City R. Co., 47 N. Y. 475; *s. c.* 7 Am. Rep. 469; Independence *v.* Jekel, 38 Iowa, 427; Severin *v.* Eddy, 52 Ill. 189; Norwich *v.* Breed, 30 Conn. 535. See 2 Thomp. Neg. 789.

[1] Nickerson *v.* Wheeler, 118 Mass. 295.

[2] 1 Mees. & W. 504.

case if such negligence could be divided between the whole."[1] On the other hand, if there is no element of wrong-doing, but if the directors of a turnpike company assume by contract the position of *sureties* for the corporation, as where they make and indorse a note on which money is borrowed for its use, they are, in the absence of any special agreement, responsible mutually, and liable to contribution in case of loss, in favor of any one director who pays more than his proportionate share.[2]

§ 4377. Whether Contribution in Case of Affirmative Acts done Contrary to Statutory Prohibitions.—When, therefore, a *director* has become personally liable to pay a debt of the corporation, or to pay a penalty, by reason of having assented to the doing of some affirmative act prohibited by statute, he has no right of contribution against mere *stockholders;* since in such a case the directors and stockholders do not stand on a common footing.[3] And so it has been held that directors who have, without the consent of the stockholders, contracted debts *in violation of* one of the *articles of incorporation* prohibiting the directors from contracting an indebtedness in excess of sixty-five per cent of the capital stock, and who have given their personal obligation for the same, are not entitled to contribution *from the other stockholders.*[4] But judicial authority is not uniform even to this doctrine. In the English court of chancery the question of contribution between co-directors came before Vice-Chancellor Bacon in a different shape. The directors of a company had, acting *ultra vires,* passed a resolution under which certain shares of the company were purchased with the funds of the company and transferred to one of the directors in trust for the company. The transaction was not characterized by bad faith or moral turpitude. The company having been ordered to be wound up, this director was put upon the list of con-

[1] Andrews *v.* Murray, 33 Barb. (N. Y.) 354, 356.

[2] Slaymaker *v.* Grandacker, 10 Serg. & R. (Pa.) 75.

[3] Stone *v.* Fenno, 6 Allen (Mass.), 579.

[4] Heald *v.* Owen, 79 Iowa, 23; *s. c.* 44 N. W. Rep. 210.

tributories and compelled to pay calls in respect of the shares. It was held that he could maintain a bill in equity for contribution from his co-directors, Vice-Chancellor Bacon saying: "It would be against every principle of justice and reason that the persons who were parties to the transaction should say to the one of them who, by their resolution and direction, is by name the only person under a legal liability, that he should bear that exclusively, as between him and themselves."[1] We have elsewhere referred to a decision[2] where one shareholder voluntarily paid a debt of the corporation under a statute making him liable for the same, and an action for contribution against another shareholder was denied to him, simply because the statute did not give such a right in terms, and the statute, being in derogation of the common law, was to be construed strictly.[3] We have also had occasion to allude to a statute of that State, providing that the stockholders of corporations should not be liable to pay the corporate debts till after the property of its officers had been exhausted. With such a decision for a precedent, and such a statute in force, it is clear that where the directors or other officers of a corporation have been compelled, on account of their own defaults, to pay the debts of the corporation, they cannot have contribution from the shareholders. This would be so on principle, for the directors and shareholders are not *in æquali jure*.[4] Under a statute providing that an officer of a corporation who

[1] Ashhurst *v.* Mason, L. R. 20 Eq. 225, 236.

[2] Andrews *v.* Callender, 13 Pick. (Mass.) 484.

[3] The general rule is, that a stockholder who has been compelled to pay more than his share of the debts of the corporation may have an action for contribution against the other stockholders. Aspinwall *v.* Torrance, 1 Lans. (N. Y.) 381; Farrow *v.* Bivings, 13 Rich. Eq. (S. C.) 25; Gray *v.* Coffin, 9 Cush. (Mass.) 192; Stewart *v.* Lay, 45 Iowa, 604, 614. In Pennsylvania the right is said to be purely statutory. Brinham *v.* Wellersburg Coal Co., 47 Pa. St. 43, 49. On obvious grounds a shareholder cannot have contribution against the other shareholders till he has exhausted his remedy against the corporation itself: Gray *v.* Coffin, 9 Cush. (Mass.) 192, 208. For the principles on which contribution in such cases is decreed, and the proceedings in actions for contribution, see Thompson on Stockholders, § 376.

[4] Stone *v.* Fenno, 6 Allen (Mass.), 579.

has paid a corporate debt for which, by the statute, he is made liable, shall have no claim against the stockholders individually for contribution,[1] a director who pays a judgment rendered against himself as indorser of a note of the corporation issued with his consent, but in excess of its statutory limit of indebtedness, acquires no right of contribution against the other stockholders. The purpose of the statute is to relieve the stockholders from individual liability for debts of the corporation for which the officers become liable in consequence of their violations of the statute.[2]

§ 4378. Statutes Granting or Withholding This Right. Statutes are found which in terms grant a right of contribution among the wrong-doing directors themselves;[3] and the statutes of several States, with great unanimity, give a right of reimbursement *against the company*, and at the same time prohibit any such right against the other shareholders.[4] Outside of statutes, a director of a corporation, against whom a judgment has been rendered for assenting to a dividend greater than the profits, has no right of *subrogation* against the company.[5] But of course directors may have such a right, as among themselves, where they have become personally liable for the debts of the company, under an agreement for contribution among themselves.[6]

[1] Gen. Laws N. H., ch. 149, § 21.

[2] Connecticut River Sav. Bank *v.* Fiske, 62 N. H. 178.

[3] Gen. Stats. Vt. 1862 (Appendix 1870), p. 567, § 19.

[4] Gen. Stats. N. H. 1867, p. 282, § 15; *Ibid.*, p. 283, § 21; Rev. Stats. N. J. 1877, p. 194, § 95; 2 Bright. Purd. Dig. Pa. 1873, p. 1410, § 35; Gen. Stats. R. I. 1872, p. 307, § 23; Rev. Stats. S. C. 1873, p. 363, § 37.

[5] Hill *v.* Frazier, 22 Pa. St. 320.

[6] See Smith *v.* Morrill, 54 Me. 48; cited in Coolidge *v.* Wiggin, 62 Me. 568, 571.

CHAPTER LXXXV.

COMPENSATION OF DIRECTORS AND OFFICERS.

SECTION
4380. Directors not entitled to compensation unless, etc.
4381. Cannot vote themselves salaries or compensation.
4382. Especially after the services have been rendered.
4383. Illustrations of the two preceding sections.
4384. Directors cannot recover for "extra" services incidental to their official duties.
4385. Illustrations of the foregoing.
4386. But may recover for services clearly outside such duties.
4387. Illustrations of the foregoing.
4388. Services prior to organization of corporation.
4389. Recovery of money misappropriated in payment of salaries.

§ 4380. Directors not Entitled to Compensation, unless, etc.—We may open this discussion with the general proposition that directors of corporations, like other trustees,[1] *presumptively serve without compensation*, and are not entitled to claim compensation for their services, unless the governing statute, or some by-law, regulation, resolution, or contract, made or assented to by the corporation at large, and not merely by the directors themselves, gives it to them. The scope of this rule is such that they are not entitled to recover from the corporation compensation for any services incidental to their office of director.[2] The law does not *imply a promise* to pay for such services, although rendered to the corporation

[1] American &c. R. Co. *v.* Miles, 52 Ill. 174.

[2] Hall *v.* Vermont &c. R. Co., 28 Vt. 401; Pierson *v.* Thompson, 1 Edw. Ch. (N. Y.) 212; Brown *v.* Republican Mountain Silver Mines, 17 Col. 421; *s. c.* 16 L. R. A. 426; 30 Pac. Rep. 66; Burns *v.* Commencement Bay Land &c. Co., 4 Wash. 558; *s. c.* 30 Pac. Rep. 668; 30 Pac. Rep. 709; Loan Asso. *v.* Stonemetz, 29 Pa. St. 534; Dunston *v.* Imperial Gas Co., 3 Barn. & Ad. 125; Smith *v.* Putnam, 61 N. H. 632; Burns *v.* Beck, 83 Ga. 471; *s. c.* 10 S. E. Rep. 121; Eakins *v.* American White Bronze Co., 75 Mich. 568; *s. c.* 42 N. W. Rep. 982; American &c. R. Co. *v.* Miles, 52 Ill.

upon request; since a person rendering gratuitous service, in the line of his *legal duty,* does not thereby raise an implication that they are rendered at the request of the party benefited by them.[1] The governing principle was more fully stated by Mr. Justice Morton, in a case in Massachusetts, and re-quoted by Mr. Chief Justice Fuller in a case in the Supreme Court of the United States, thus: "A bank or other corporation may be bound by an implied contract in the same manner as an individual may. But, in any case, the mere fact that valuable services are rendered for the benefit of a party does not make him liable upon an implied promise to pay for them. It often happens that persons render services for others which all parties understand to be gratuitous. Thus, directors of banks and of many other corporations usually receive no compensation. In such cases, however valuable the services may be, the law does not raise an implied contract to pay by the party who receives the benefit of them. To render such party liable as a debtor under an implied promise, it must be shown, not only that the services were valuable, but also that they were rendered under such circumstances as to raise the fair presumption that the parties intended and understood that they were to be paid for; or, at least, that the circumstances were such that a reasonable man, in the same situation with the person who receives and is

174; Maux Ferry Gravel Co. *v.* Branegan, 40 Ind. 361; Kilpatrick *v.* Penrose F. &c. Co., 49 Pa. St. 118; *s. c.* 88 Am. Dec. 497; Martindale *v.* Wilson-Cass Co., 134 Pa. St. 348; *s. c.* 19 Am. St. Rep. 706; Bkg. L. J. 345; Rockford &c. R. Co. *v.* Sage, 65 Ill. 328; *s. c.* 16 Am. Rep. 587; Sawyer *v.* Pawner's Bank, 6 Allen (Mass.), 207; Pew *v.* First Nat. Bank, 130 Mass. 391; Cheeney *v.* Lafayette &c. R. Co., 68 Ill. 570; *s. c.* 18 Am. Rep. 584; New York &c. R. Co. *v.* Ketchum, 27 Conn. 170, 180; Butts *v.* Wood, 37 N. Y. 317; Merrick *v.* Peru Coal Co., 61 Ill. 472; Holder *v.* Lafayette &c. R. Co., 71 Ill. 106; *s. c.* 22 Am. Rep. 89; Wood *v.* Lost Lake &c. Co., 23 Or. 20; *s. c.* 37 Am. St. Rep. 651; 23 Pac. Rep. 848. Valuable *notes* on the compensation of officers and agents of corporations will be found in 23 Am. & Eng. Corp. Cas. 616; 3 L. R. A. 378; 37 Am. & Eng. R. Cas. 277.

[1] Loan Asso. *v.* Stonemetz, 29 Pa. St. 534; Rockford &c. R. Co. *v.* Sage, 65 Ill. 328; *s. c.* 16 Am. Rep. 587; American &c. R. Co. *v.* Miles, 52 Ill. 174.

benefited by them, would and ought to understand that compensation was to be paid for them."[1]

§ 4381. Cannot Vote Themselves Salaries or Compensation. — We have already considered at length the principle that directors of corporations occupy such a fiduciary position as prevents them from dealing in their own behalf, in respect to any matter involving the confidence springing out of their office of trustee for the corporation and the shareholders.[2] In the discussion of this principle, we have seen that the right of a director to vote at a board meeting, upon a question in which he is personally interested in a sense different from the rest of the stockholders, is generally denied by the courts.[3] In pursuance of this principle, it is almost universally held that directors have no power to vote appropriations of money to themselves, by way of salary or compensation for their services, either before or after the rendition of such services.[4] Such a resolution is *void*, as being a promise without a *con-*

[1] Pew *v.* First Nat. Bank, 130 Mass. 391, 395; quoted with approval in Fitzgerald &c. Co. *v.* Fitzgerald, 137 U. S. 98.

[2] *Ante*, § 4009, *et seq.;* Duncomb *v.* New York &c. R. Co., 84 N. Y. 190, 199; Hodges *v.* New England Screw Co., 1 R. I. 312; *s. c.* 53 Am. Dec. 624.

[3] *Ante*, §§ 4042, 4065.

[4] Gardner *v.* Butler, 30 N. J. Eq. 702; Jones *v.* Morrison, 31 Minn. 140; Ward *v.* Davidson, 89 Mo. 445; Butts *v.* Wood, 37 N. Y. 317 (affirming *s. c.* 38 Barb. (N. Y.) 181); Kelsey *v.* Sargent, 40 Hun (N. Y.), 150; McNaughton *v.* Osgood, 41 Hun (N. Y.), 109; *s. c.* 3 N. Y. St. 795; Blatchford *v.* Ross, 54 Barb. (N. Y.) 48; *s. c.* 37 How. Pr. (N. Y.) 115; 5 Abb. Pr. (N. S.) (N. Y.) 434; Copeland *v.* Johnson Man. Co., 47 Hun (N. Y.), 235; Shattuck *v.* Oakland Smelting &c. Co., 58 Cal. 550; Loan Asso. *v.* Stonemetz, 29 Pa. St. 534; New York &c. R. *v.* Ketchum, 27 Conn. 170, 183; Maux Ferry Gravel Road Co. *v.* Branegan, 40 Ind. 361; Wickersham *v.* Crittenden, 93 Cal. 17; *s. c.* 28 Pac. Rep. 788; Chamberlain *v.* Pacific Wool Co., 54 Cal. 103; Miner *v.* Belle Isle Ice Co., 93 Mich. 97; *s. c.* 53 N. W. Rep. 218; 17 L. R. A. 412; Davis Mill Co. *v.* Bennett, 39 Mo. App. 460; Mallory *v.* Mallory-Wheeler Co., 61 Conn. 131; *s. c.* 23 Atl. Rep. 708; 11 Rail. & Corp. L. J. 169; Wickersham *v.* Crittenden, 93 Cal. 17; *s. c.* 28 Pac. Rep. 788; Bennett *v.* St. Louis Car Roofing Co., 19 Mo. App. 349. *Contra* and *alone:* McNab *v.* McNab &c. Man. Co., 62 Hun, 18; *s. c.* 16 N. Y. Supp. 448.

sideration, and hence it cannot be enforced in an action;[1] and in an action founded on such a resolution, it is not *admissible in evidence.*[2] But it has been reasoned that, while no recovery can be had for services audited by a vote of the directors, as upon an *express contract,* yet where the services are such that compensation ought to be rendered for them, as being *services outside the duties of the director,*[3] a recovery can be had upon a *quantum meruit.*[4] The director who claims compensation for his services being disqualified from voting on the question,[5] if he is necessary to make up a quorum of the board,[6] or if his vote is necessary to the result,[7] the resolution will be void in the sense already stated. Nor can this principle be evaded by such shallow devices as for the majority of the directors, who are the only salaried officers, to appoint one of their own number as *agent* for the corporation to make a contract with each of the others, renewing a previous contract to pay a salary for his services, and then appointing another director agent to make a similar contract with the one previously appointed agent for the payment of his salary as director;[8] nor where one person controls a majority of the stock, and acts as president of the corporation, by his device of electing a board of directors composed entirely of *dummies,* to whom he furnishes shares to qualify them, and who vote a salary to him.[9] But where his vote is not necessary to the valid adop-

[1] Loan Asso. *v.* Stonemetz, 29 Pa. St. 534; Copeland *v.* Johnson Man. Co., 47 Hun (N. Y.), 235; Gardner *v.* Butler, 30 N. J. Eq. 702.

[2] Shattuck *v.* Oakland Smelting &c. Co., 58 Cal. 550.

[3] As to which, see *post,* § 4386.

[4] Gardner *v.* Butler, 30 N. J. Eq. 702.

[5] *Ante,* §§ 4042, 4065.

[6] Butts *v.* Wood, 37 N. Y. 317.

[7] Copeland *v.* Johnson Man. Co., 47 Hun (N. Y.), 235; Davis Mill Co. *v.* Bennett, 39 Mo. App. 460; Wickersham *v.* Crittenden, 93 Cal. 17; *s. c.* 28 Pac. Rep. 788.

[8] Mallory *v.* Mallory-Wheeler Co., 61 Conn. 131; *s. c.* 11 Rail. & Corp. L. J. 169; 23 Atl. Rep. 708.

[9] Miner *v.* Belle Isle Ice Co., 93 Mich. 97; *s. c.* 53 N. E. Rep. 218; 17 L. R. A. 412. According to one decision, the officers of a corporation have the same difficulty in *reducing their salaries,* where they have already been fixed by competent authority; they generally accomplish this by mutually agreeing among themselves so to do, but the agreement must be made with the corporation, and communicated to or accepted by its directors (Richard Thompson Co. *v.* Brooks,

tion of the resolution, it will be good, although he may have voted for it.[1]

§ 4382. Especially after the Services have been Rendered. Especially is it the law that directors cannot vote themselves compensation for services previously rendered.[2] The foundation of this doctrine is that the directors and managing officers of a corporation are *trustees* in equity for its shareholders, and also in a sense for its creditors; and this rule is analogous to the rule of the English court of chancery, which denies to a trustee the right to compensation. Reasoning thus, it has been said: "One holding a position of trust cannot use it to promote his individual interest in any manner, in disposing of the trust property." And where an officer had received an allowance of a bill for past services by

37 N. Y. St. Rep. 506; *s. c.* 14 N. Y. Supp. 370); though we suppose that it would be lawful for them, after receiving their salaries, which they are bound as good citizens to do, to cover the money back into the treasury of the corporation. On the other hand, there is a decision to the effect that an agreement between the president of a corporation and its creditors, whereby the president is to forego his salary, and the creditors are to refrain from proceedings against the company, but where no period is stipulated during which they so bind themselves, is of no value for want of *consideration* and *mutuality*. Snow *v.* Russell Coe Fertilizer Co., 58 Hun, 134; *s. c.* 33 N. Y. St. Rep. 959; 11 N. Y. Supp. 492.

[1] Clark *v.* American Coal Co., 86 Iowa, 436; *s. c.* 53 N. W. Rep. 291. On the contrary, for a case where the vice-president *presided* at a meeting of the trustees when the salaries of the officers, including his own, were fixed, and where, notwithstanding his testimony and a record entry to the effect that he had not voted on the question, the resolution was declared invalid, see Ashley *v.* Kinnan, 18 N. Y. St. Rep. 791; *s. c.* 2 N. Y. Supp. 574.

[2] Holder *v.* Lafayette &c. R. Co., 71 Ill. 106; *s. c.* 22 Am. Rep. 89; Kilpatrick *v.* Penrose &c. Co., 49 Pa. St. 118; *s. c.* 88 Am. Dec. 497; Loan Asso. *v.* Stonemetz, 29 Pa. St. 534; New York &c. R. Co. *v.* Ketchum, 27 Conn. 170; Henry *v.* Rutland &c. R. Co., 27 Vt. 435; Butts *v.* Wood, 37 N. Y. 317; Gridley *v.* Lafayette &c. R. Co., 71 Ill. 200; Martindale *v.* Wilson-Cass Co., 134 Pa. St. 348; 26 Week. Not. Cas. 48; *s. c.* 19 Am. St. Rep. 706; 19 Atl. Rep. 680; Smith *v.* Putnam, 61 N. H. 632; Ashton *v.* Dashaway Asso., 84 Cal. 61; 7 L. R. A. 809; *s. c.* 22 Pac. Rep. 660; Jones *v.* Morrison, 31 Minn. 140; State *v.* Peoples' Mut. Benefit Asso., 42 Ohio St. 579; Wood *v.* Lost Lake &c. Co., 23 Or. 20; *s. c.* 37 Am. St. Rep. 761; 23 Pac. Rep. 848; Bennett *v.* St. Louis Car Roofing Co., 19 Mo. App. 349. Compare Stewart *v.* St. Louis &c. R. Co., 41 Fed. Rep. 736.

the board, it was said, "that the circumstances under which the bill was allowed were a fraud upon its stockholders, and to permit such a transaction to stand would be a reproach to the administration of justice."[1] In another case it was said: "It would be a sad spectacle to see the managers of any corporation . . . . assembling together and parceling out among themselves the obligations or other property of the corporation in payment of past services."[2]

§ 4383. Illustrations of the Two Preceding Sections.— Certain persons organized a corporation, elected themselves officers, proceeded to business, contracted debts, and then, before all the stock had been subscribed for and ten per cent paid in, as required by the governing statute, undertook to appropriate to themselves, under the name of salary, certain of its assets. It was held that this would not be allowed.[3] A director did work in an effort to organize a corporation in another State, in pursuance of an arrangement between himself and his co-directors, but without any agreement as to his remuneration. Although the services were for the general corporate advantage, this did not impose any liability upon the corporation to pay for them.[4] It has been held that a *donation* by trustees of an incorporated benevolent association to each member, in pursuance of a unanimous vote of the members present at a meeting when the vote was taken, of a certain sum for past services, when no services had been rendered other than such as the parties were bound to render as members, is a *misappropriation of corporate funds*, the restoration of which may be compelled by a member who was not a party to the transaction.[5]

§ 4384. Directors cannot Recover for "Extra" Services Incidental to their Official Duties.— It is a part of the doctrine of the preceding sections that a director cannot recover from the corporation compensation for services which may fairly be deemed incidental to his duties as director, and to

[1] Butts *v.* Wood, 37 N. Y. 317.

[2] New York &c. R. Co. *v.* Ketchum, 27 Conn. 170, 183.

[3] Burns *v.* Beck, 83 Ga. 471; *s. c.* 10 S. E. Rep. 121.

[4] Eakins *v.* American White Bronze Co., 75 Mich. 568; *s. c.* 42 N. W. Rep. 982.

[5] Ashton *v.* Dashaway Asso., 84 Cal. 61; *s. c.* 22 Pac. Rep. 660; 7 L. R. A. 809.

have been undertaken by him in virtue of his office.[1] The danger of corruption and abuse is so great, in admitting the principle that a director can recover compensation for services to the corporation rendered while he is a director, that it has been well held that he is not entitled to such compensation, unless the services are most unquestionably beyond the range of his official duties,[2] and rendered under circumstances warranting the conclusion that it was understood by the proper corporate officers, as well as by himself, that they were to be paid for.[3] Another court has gone even further — perhaps too far — in holding that, although the services performed by the director are out of the ordinary course of his duties, yet he will be entitled to no compensation for them so long as his office of director continues; and that a resolution of the board, allowing compensation for such services, imposes no obligation upon the corporation to pay for them.[4]

§ **4385. Illustrations of the Foregoing.** — In pursuance of the foregoing principle, it has been held that a director of a bank cannot claim a *reward* offered by the bank for the discovery of the *robber* of the bank and the recovery of the money stolen; since it is his duty, if he obtains any information upon the subject, to communicate it to the bank without reward.[5] A trustee appointed by the charter of a bank, to subscribe for a certain amount of stock, but for whom no compensation was provided by the charter, was not to be entitled to any compensation for his services, though the *cestui que trust* had given him a power of attorney to perform substantially

[1] Hodges *v.* Rutland &c. R. Co., 29 Vt. 220; Pierson *v.* Thompson, 1 Edw. Ch. (N. Y.) 212; Cheeney *v.* Lafayette &c. R. Co., 68 Ill. 570; *s. c.* 18 Am. Rep. 584; Pew *v.* First Nat. Bank, 130 Mass. 391.

[2] New York &c. R. Co. *v.* Ketchum, 27 Conn. 170.

[3] Brown *v.* Republican Mountain Silver Mines, 17 Colo. 421; *s. c.* 30 Pac. Rep. 66.

[4] Branch Bank *v.* Collins, 7 Ala. 95; Branch Bank *v.* Scott, 7 Ala. 107. In these cases it is noticeable that a liberal compensation had been fixed by law for the ordinary services of a director. The holding was that, under the statute fixing the compensation of directors of the State bank, a director of a branch bank, receiving the compensation provided by law, can be allowed no compensation by the board for extra services while he continues a director.

[5] Stacy *v.* Bank of Illinois, 5 Ill. 91.

the same acts authorized by the bank charter.[1] Where the board of directors had voted a certain compensation for special services, it was held that a director could not recover any higher compensation than that so voted, for any services of such a nature that they could only have been rendered by a director;[2] nor could he, in addition to or in lieu of the compensation provided by the resolution, claim a *commission* for the negotiation of the defendant's bonds.[3] So, a director of a railway company cannot recover from the company the reasonable value of services rendered by him, as a member of the *executive committee* of its directors, in making efforts to *contract for the construction of its road*, which services include compensation for time and travel; since these are a part of his duty as director. "Nor is it an answer to say that the company could have intrusted the duties of the executive committee to others not directors or even stockholders, and paid them a fair compensation for their time and skill. They had the power to so act as directors, and they as directors, or as a part of them, performed the services."[4] So, it has been held not competent for the directors of a foreign steamship corporation to create a *trust* in certain of their own number who are American citizens, for the purpose of giving their steamships the privileges of American vessels, and thereby create a claim to compensation in favor of such trustees for the performance of their duties.[5] So, according to another holding, where the director of a corporation performs services which may be regarded as incidental to his duties as director, as where he acts as treasurer of the corporation, his salary, fees, or compensation as treasurer must be fixed by the board of directors before he enters upon the duties of treasurer; otherwise, he cannot recover compensation afterwards.[6] A director and president of an incorporated bank, who receives a salary as president, cannot recover from the bank additional compensation for acting as a member of "a *committee on alterations and repairs*," and superintending the repairs of a building purchased by the bank although his services were valuable to it.[7]

[1] Pierson *v.* Thompson, 1 Edw. Ch. (N. Y.) 212.

[2] Hodges *v.* Rutland &c. R. Co., 29 Vt. 220.

[3] *Ibid.*

[4] Cheeney *v.* Lafayette &c. R. Co., 68 Ill. 570; *s. c.* 18 Am. Rep. 584, 588.

[5] Ogden *v.* Murray, 39 N. Y. 202.

[6] Holder *v.* Lafayette &c. R. Co., 71 Ill. 106; *s. c.* 22 Am. Rep. 89.

[7] Pew *v.* First Nat. Bank, 130 Mass. 391.

§ 4386. But may Recover for Services Clearly Outside Such Duties.—On the other hand, a director, or other officer of a corporation, can recover on an express or implied *assumpsit*, for services rendered the corporation, provided such services are clearly outside the scope of his duties as such officer.[1] One court has perhaps gone too far in laying it down, as a general proposition, that directors are not bound to render any services to the corporation beyond their board meetings; and accordingly that if, by a vote of the board, a director be empowered to transact certain business, he will be entitled to a reasonable compensation, in the absence of some agreement to the contrary.[2] Directors may, however, as already seen,[3] appoint one of their number an *agent* to perform any ministerial act, or transact any business, such as they might commit to an agent who is not a director; and where this is done in good faith and valuable services are rendered by him as such agent, it would be an unreasonable and unjust extension of the rule under consideration to deny him compensation.[4] But the implication which the law might otherwise raise of a promise on the part of a corporation to pay one of its directors for extra services, may, it seems, be repelled by long lapse of

[1] Santa Clara Mining Asso. *v.* Meredith, 49 Md. 389; *s. c.* 33 Am. Rep. 264; Gridley *v.* Lafayette &c. R. Co., 71 Ill. 200; Greensboro &c. Turnpike Co. *v.* Stratton, 120 Ind. 294; *s. c.* 22 N. E. Rep. 247; Prilliman *v.* Mendenhall, 120 Ind. 279; *s. c.* 22 N. E. Rep. 247; Evans *v.* Trenton, 24 N. J. L. 764, 769; Chandler *v.* Monmouth Bank, 13 N. J. L. 255; Lafayette &c. R. Co. *v.* Cheeney, 87 Ill. 446; *s. c.* 68 Ill. 570; 18 Am. Rep. 584; Henry *v.* Rutland &c. R. Co., 27 Vt. 435; Hodges *v.* Rutland &c. R. Co., 29 Vt. 220; doctrine recognized in Citizens' Nat. Bank *v.* Elliott, 55 Iowa, 104; *s. c.* 39 Am. Rep. 107; Fitzgerald &c. Co. *v.* Fitzgerald, 137 U. S. 98; Brown *v.* Republican Mountain Silver Mine, 17 Colo. 421; *s. c.* 30 Pac. Rep. 66; 16 L. R. A. 426. That a trustee of a corporation organized under the Manufacturing Act (N. Y. Laws 1848, ch. 40) cannot recover for services rendered to the corporation,—see McDowell *v.* Sheehan, 129 N. Y. 200; reversing *s. c.* 36 N. Y. St. Rep. 104; and 13 N. Y. Supp. 386.

[2] Shackelford *v.* New Orleans &c. R. Co., 37 Miss. 202.

[3] *Ante*, § 3907.

[4] Chandler *v.* Monmouth Bank, 13 N. J. L. 255; Henry *v.* Rutland &c. R. Co., 27 Vt. 435; Hodges *v.* Rutland &c. R. Co., 29 Vt. 220; Lafayette &c. R. Co. *v.* Cheeney, 87 Ill. 446; *s. c.* 68 Ill. 570; 18 Am. Rep. 584; Waller *v.* Bank of Kentucky, 3 J. J. Marsh. (Ky.) 201, 206; Shackelford *v.* New Orleans &c. R. Co., 37 Miss. 202.

time. Thus it has been held that where a director renders extra services for the corporation, and presents no account, and makes no claim for compensation during *eight years* thereafter, and continues director during that time, he cannot recover on an implied promise to pay.[1]

§ **4387. Illustrations of the Foregoing.** — Thus, where a director of a railway company is appointed an *agent*, by a resolution to *solicit subscriptions of stock*, or to *procure the right of way*, he may recover for such *services* when rendered by him. But he cannot recover for services performed as a member of the executive committee, nor in making efforts to contract for the construction of the road, including time and travel, as these are a part of his duties as director.[2] He may recover where he rendered services at the request of the president and directors, as *land commissioner, and as attorney;*[3] or as its *attorney*, and also in procuring *aid notes, right of way*, and *enlisting capitalists* in the enterprise;[4] or as *superintendent, treasurer*, and *general manager;*[5] or *as secretary*, under a resolution of appointment which does not specify his compensation.[6] So, a director of a bank, although not entitled to compensation for extra services rendered while in that capacity, may be allowed for services rendered *before he became director*, and may also receive, on behalf of other persons, compensation due them for services they have performed.[7] Following out the same line of thought, it has been held that a vote of the directors of a railroad, limiting the amount *per diem* of pay allowable to a director for special services, does not apply to work done by a director in an entirely different capacity, and in one where the services could have been performed by persons not directors, as agents.[8] So, a provision in the charter of a bank, that "no director shall be entitled to any emolument unless the same

[1] Utica Ins. Co. *v.* Bloodgood, 4 Wend. (N. Y.) 652.

[2] Cheeney *v.* Lafayette &c. R. Co., 68 Ill. 570; *s. c.* 18 Am. Rep. 584; Lafayette &c. R. Co. *v.* Cheeney, 87 Ill. 446.

[3] Rogers *v.* Hastings &c. R. Co., 22 Minn. 25.

[4] Ten Eyck *v.* Pontiac &c. R. Co., 74 Mich. 226; *s. c.* 16 Am. St. Rep. 633; 41 N. W. Rep. 905; 5 Rail. & Corp. L. J. 401; 21 Chic. Leg. N. 275.

[5] Fitzgerald &c. Co. *v.* Fitzgerald, 134 U. S. 98.

[6] Rogers *v.* Hastings &c. R. Co., 22 Minn. 25.

[7] Branch Bank *v.* Collins, 7 Ala. 95.

[8] Henry *v.* Rutland &c. R. Co., 27 Vt. 435; Hodges *v.* Rutland &c. R. Co., 29 Vt. 220.

shall have been allowed by the stockholders at a general meeting," has been held to apply to the directors in their official capacity only, and not to prevent them from taking compensation for services rendered individually by them, as *agents* of the bank.[1] So, where the *president* of a *steam packet company commanded one of the boats* of the company for three years, and retained from the funds of the company a reasonable salary, — here it was held that he was entitled to retain the same.[2] So, where there were facts and circumstances in evidence which warranted the jury in finding that the president and director of a *mining company* had been employed by the corporation to act for it in *obtaining a patent for certain lands* in California, in *obtaining a loan* in London, and in *procuring the surrender and cancellation* of the first mortgage *bonds* of the company, which surrender and cancellation were necessary to the obtaining of the loan; and there was evidence tending to prove that these services were either authorized by the corporation previous to their rendition, or ratified by it after their performance, and that they were not such services as were required of him in the discharge of his duties as director, — a verdict and judgment awarding him compensation for the services were affirmed.[3]

§ 4388. Services Prior to Organization of Corporation.— In the view of some courts, one who becomes a director of a corporation cannot maintain an action against the corporation for services rendered prior to its organization in *promoting* its existence, and the theory of these courts seems to go to the length of holding that no one can maintain such an action.[4] Clearly, the *executive committee* of a company have no right to *vote money to themselves*,[5] in addition to their

[1] Chandler *v.* Monmouth Bank, 13 N. J. L. 255.

[2] New Orleans &c. Packet Co. *v.* Brown, 36 La. An. 138; *s. c.* 51 Am. Rep. 5.

[3] Santa Clara Mining Asso. *v.* Meredith, 49 Md. 389; *s. c.* 33 Am. Rep. 264. Circumstances under which a promoter was not entitled to share in the compensation offered by the proprietor of certain lands, to the promoters of a corporation organized to promote the sale of such lands: Armstrong *v.* Ebener, 46 N. J. Eq. 457; *s. c.* 19 Atl. Rep. 265.

[4] *Ante*, § 480, *et seq.;* Rockford &c. R. Co. *v.* Sage, 65 Ill. 328; *s. c.* 16 Am. Rep. 587; New York &c. R. Co. *v.* Ketchum, 27 Conn. 170; Franklin Fire Ins. Co. *v.* Hart, 31 Md. 59; Safety Deposit Life Ins. Co. *v.* Smith, 65 Ill. 309.

[5] *Ante*, §§ 4042, 4381.

regular compensation, for their services as promoters and originators of the company, or in consideration of the members retiring from the executive committee. And if large sums are granted for those purposes, this affords a good reason for the appointment of a receiver.[1] The following case illustrates an extreme view of this doctrine: A director of a railroad corporation rendered special services in *procuring subscriptions* to the stock of the company and in its organization, which services were rendered on his part in the expectation of compensation. The stockholders voted to grant him a free *pass over* the road for himself and family during his life, which grant was inadequate as a compensation for the services, but was accepted by him as such. Some years afterwards the stockholders rescinded the vote. It was held, in an action brought by the company for railroad fares accruing after that time, that the services rendered created no indebtedness, and could not constitute a consideration for the contract; and it would have made no difference, if the services had been rendered upon an express understanding with his associates that he was to be paid by the company after its organization. The court reasoned that, aside from the technical difficulty of binding the corporation before its existence, the policy of the law wholly discountenances such arrangements.[2] On the contrary, some courts, as already seen,[3] hold a corporation liable for services necessarily rendered in bringing it into existence, on a theory resembling that of *ratification:* the corporation takes the benefit of the acts thus done in its favor, and takes them *cum onere.*[4] But it is said that the acts for which the corporation may be thus charged

[1] Blatchford *v.* Ross, 54 Barb. (N. Y.) 42; *s. c.* 5 Abb. Pr. (N. S.) (N. Y.) 434; 37 How. Pr. (N. Y.) 110.

[2] New York &c. R. Co. *v.* Ketchum, 27 Conn. 170. See also Armstrong *v.* Ebener, 46 N. J. Eq. 457; *s. c.* 19 Atl. Rep. 265; Van Valkenburgh *v.* Thomasville &c. R. Co., 4 N. Y. Supp. 782; Tifft *v.* Quaker City Nat. Bank, 8 Pa. Co. Ct. Rep. 606.

[3] *Ante,* § 490; *post,* §§ 5321, 5322.

[4] Bell's Gap R. Co. *v.* Christy, 79 Pa. St. 54; *s. c.* 21 Am. Rep. 39. Compare First Nat. Bank *v.* Hoch, 89 Pa. St. 324; *s. c.* 33 Am. Rep. 769; Twelfth Street Market Co. *v.* Jackson, 102 Pa. St. 269.

must have been authorized by a *majority of the stockholders;* and consequently a corporation was not liable for the promise made by a *single stockholder* to pay for services in securing subscriptions to its capital stock, in the absence of any proof of a ratification.[1]

§ **4389. Recovery of Money Misappropriated in Payment of Salaries.** — Money so misappropriated by the directors of a corporation may be recovered by the *corporation* or its representative in an ordinary action at law, it is assumed,[2] or by a suit in equity proceeding on the jurisdictional grounds of *fraud* and *trust;*[3] or by a single stockholder suing for himself and the others,[4] in case those in control of the corporation refuse to institute suit in its name, — in which latter case the action is always in equity.[5] The form of relief is varied according to the circumstances of the case. The officers of the corporation have *no lien* upon its funds for their services;[6] and where a person, in order to secure his pay as president and attorney of a private corporation, caused its secretary to assign to him certain certificates of purchase of land held by the corporation and in their possession as officers thereof, — it was held that a court of equity might compel an unconditional return of them.[7] Where the directors of a corporation, knowing the corporation to be insolvent, received from the treasurer payment for *past services* as directors, it was held that the *assignee* of the corporation could maintain an action to recover back the money paid.[8] If those in charge of the machinery of the corporation neglect, after request by the stockholder, to bring the suit, then a court of equity will open its door to him, he suing on behalf of himself and the other stockholders, and will render

[1] Tift *v.* Quaker City Nat. Bank, 141 Pa. St. 550; *s. c.* 9 Rail. & Corp. L. J. 426; *s. c.* 21 Atl. Rep. 660.

[2] *Ante,* § 4119.

[3] *Ante,* § 4120.

[4] *Post,* § 4566.

[5] *Post,* § 4479.

[6] Emporium &c. Co. *v.* Emrie, 54 Ill. 345. So held in case of the cashier of an insolvent bank, in Bruyn *v.* Middle Dist. Bank, 1 Paige (N. Y.), 584.

[7] Emporium &c. Co. *v.* Emrie, *supra.*

[8] Smith *v.* Putman, 61 N. H. 632.

a decree for the repayment of the money to the corporation, or for other appropriate relief.[1] It has been held in one case that, while resolutions adopted by the directors of a corporation paying salaries to themselves as its *officers* are not binding upon the corporation, yet, when the action to restrain the payment of such salaries is brought, not by the corporation, but by a stockholder, the burden is upon plaintiff to make such a case as will show that the corporatian ought to exercise its right to avoid the resolution made by its directors.[2] Whether this distinction is a sound one is questionable, since we have already seen that such a resolution is void in the sense that no action can be founded upon it; and another case holds that it is *prima facie voidable* at the election of a stockholder.[3] Whether there is any practical distinction between the two theories is not, however, clear; since in either case the plaintiff must show that the corporation has been or will be injured by the unlawful act. In a leading case upon this subject, it appeared that the *treasurer* of a corporation presented his claim for pay for services to the board of directors, and it was allowed; all the proceedings were strictly regular; but it was shown that the quorum of directors present at the meeting consisted of the treasurer himself, his *father*, and *another relative*. It was also proved, as matter of fact, that the payment of such compensation to the treasurer was contrary to the distinct understanding of the parties. It was held that a suit against these three directors *by one stockholder*, in behalf also of the rest, would lie, and that a judgment setting aside the transaction as an abuse of trust, and for the repayment of the money, was correct.[4] In addition to this, if the officer who has illegally appropriated compensation voted to him by the directors is under a *bond*, it may be recovered *in an action on such bond*.[5] The directors voting compensation to an

[1] Butts *v.* Wood, 38 Barb. (N. Y.) 181; *s. c.* affirmed, 37 N. Y. 317; *post*, ch. 89; McNaughton *v.* Osgood, 41 Hun (N. Y.), 109; *s. c.* 3 N. Y. St. Rep. 795; Wickersham *v.* Crittenden, 93 Cal. 17; *s. c.* 28 Pac. Rep. 788; Jones *v.* Morrison, 31 Minn. 140.

[2] McNaughton *v.* Osgood, *supra.*

[3] Jones *v.* Morrison, *supra.*

[4] Butts *v.* Wood, *supra.*

[5] Jennery *v.* Olmstead, 105 N. Y. 654, *mem.*

officer of the corporation for *past services*, may become personally liable to make good what is thereby lost to the corporation as for a breach of trust. It was so held where the president of a corporation, who had served without any agreement as to compensation, sold his stock to three persons, who thereby acquired control of the corporation and made themselves directors, and then voted a sum of money to the president for his past services, and paid the money to him in part consideration for the shares of stock which he had transferred to them. Here a *receiver* of the corporation maintained a suit in equity to recover the money so misappropriated.[1] But there being no evidence that the *president* assented to the misappropriation, or that he knew whence the money came with which he was paid for his stock, he was not liable therefor to the receiver.[2]

[1] Ellis *v.* Ward, 137 Ill. 509; *s. c.* 25 N. E. Rep. 530.

[2] *Ibid.*